Will Trudeau's Proposed Mortgage Change Cool This Housing Market?

Description

Housing prices in Canada have surged over the past year, notwithstanding the COVID-19 outbreak. The historically low-interest rates and desire for larger spaces in the suburbs have induced a buying frenzy. Now, the developing bubble could burst anytime soon.

Recent data shows that the value of the residential real estate has risen by 17% in the last 12 months. The percentage increase is crazy, and the growth's pace is too fast. Notably, the bidding wars are not only in the big cities like Montreal, Toronto, and Vancouver.

According to the Canadian Real Estate Association (CREA), the price gains in 12 major markets (about 25% of the total) are 30% or more. Given the scenario, should the administration of Prime Minister Justin Trudeau take bolder steps to calm the hot housing market in 2021?

Tighter qualification rules

The Bank of Canada is likely to maintain low interest rates a while longer. Some industry watchers wonder whether the Trudeau government has options to tackle the red-hot housing market. However, Jeremy Rubin, head of the Office of Superintendent of Financial Institutions (OSFI), has changes in mind to rein in the housing boom.

Canada's banking regulator intends to tighten qualification rules for uninsured mortgages. He fears low-interest rates will put new home buyers deep into debt. Rubin said, "Sound residential mortgage underwriting is always important for the safety and stability of financial institutions."

Proposed changes

OFSI proposes a new benchmark to determine the minimum qualifying rate for uninsured borrowers. A fixed-rate of 5.25% rate will replace the current 4.79%, the advertised rates of banks. The new measures shall take effect on June 1, 2021.

Stephen Brown, a senior Canada economist at Capital Economics, believes a higher benchmark rate will reduce the recent momentum in the prices for single-family homes. Finance Minister Chrystia Freeland said they would continue to monitor housing market conditions. Also, the Finance Department will closely examine the results of OSFI's consultations.

Recovering top REIT

Canada's housing market is resilient as ever, but people looking to buy real estate investment properties should beware. Some industry experts say the boom is inexplicable. Due to speculations, the real estate prices could be overvalued. Prices could fall significantly if the bubble bursts.

For now, real estate investment trusts (REITs) appear to be safer alternatives. The cash outlay is lower, and you earn rental-like income from dividends. **RioCan** (TSX:REI.UN), one of the prominent landlords in Canada, had a horrendous 2020.

While it posted a net income of $65.6 million in Q4, the net loss for the year was $64.8 million. In case of unresolved tenant defaults, RioCan can offset rents via the approximately $28.6 million it holds as security deposits. Some tenants also issued letters of credit worth around $4.6 million.

However, the shares of this $6.43 billion REIT have gained 22.52% thus far in 2021. If you were to invest today, the share price is $20.25, while the dividend yield is still decent at 4.78%. A $50,000 investment will produce $2,390 in passive income.

Lenders' protection

The OSFI will gather feedback until May 7 and reveal the final changes by May 24, 2021. Rudin said they want to make sure lenders have protection when mortgages obtained today renew in three, four, or five years.

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cliew