Housing Market: Will the Proposed Mortgage Change Slow Down the Housing Market?

Description

Housing prices in Canada have shown no signs of declining. Valuations surged over the past year, despite the pandemic. The historically low interest rates and the need for larger spaces in the suburbs as people spend more time at home has led to a buying frenzy. The housing bubble has always been at risk of bursting, and it might happen anytime soon.

The value of the residential real estate has increased by 17% in the last 12 months. This is an outrageous increase, and the growth is happening too fast. The bidding wars are no longer limited to bigger cities like Vancouver, Toronto, and Montreal.

The Canadian Real Estate Association (CREA) reported that the price increase in 25% of the market is over 30%. Considering the worrying rates of increasing prices, it might be time that the government steps in.

Strict rules to qualify

The Bank of Canada will likely retain the low interest rates for a while longer. Some analysts are wondering whether the government has any options that it can use to slow down the frothy housing market. However, the head of the Office of Superintendent of Financial Institutions (OSFI), Jeremy Rubin, has changes in mind that could cool down the market.

The banking regulator in Canada plans to tighten the rules to qualify for uninsured mortgages. There is an increasing fear that the low interest rates can put new homeowners into debts that they cannot repay. Rubin has said that sound residential mortgage underwriting is crucial to ensure the stability and safety of financial institutions.

Proposed mortgage changes

OSFI has proposed a new benchmark to determine the minimum rate for uninsured borrowers to qualify at a fixed rate of 5.25%. The new rate will replace the existing 4.79% rate advertised by banks. These changes will come into effect on June 1, 2021.

A senior Canada economist at Capital Economics, Stephen Brown, believes that raising the benchmark rate will significantly reduce the recent momentum we are seeing in prices of single-family homes across the country. The finance minister has also said that they will continue monitoring housing market conditions.

A safer alternative for investing in real estate

Canada's housing market continues to be resilient. However, people looking to buy real estate investment properties should be cautious. Some industry experts say that this boom is completely unwarranted. The speculations could mean that real estate prices could be overvalued. If the bubble bursts, prices could decline significantly.

Real estate investment trusts (REITs) like **RioCan REIT** (TSX:REI.UN) appear to be safer alternatives to buying investment properties. The amount of cash you need to invest to get decent returns is lower, and your investment will be far more liquid than investing in a property.

RioCan had a rough year in 2020 due to the pandemic. It posted a net income of a staggering $65.5 million in Q4 2020, but its net loss for the year was almost $65 million. RioCan can offset rents for unresolved tenant defaults using its estimated $28.6 million in security deposits. The recovering REIT could be looking at a better year as 2021 continues, offering rental-like income to its shareholders through monthly payouts.

Foolish takeaway

There is still some time until the proposed changes come into effect. The OSFI will take more feedback until May 7 and finalize the changes by May 24, 2021. According to Rudin, OSFI wants to ensure that lenders have adequate protection when the mortgages obtained today renews in three, four, or five years.

A cooldown in the housing market could result in declining valuations across the board, because the market is significantly overvalued. Investing in a REIT like RioCan could be a safer way to gain exposure to the housing market and generate rental-like monthly income from your investment.

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