Looming Crisis: Will Mortgage Payments Double in 2022?

Description

In the latter part of May 2021, Bank of Canada Governor Tiff Macklem sounded an alarm. He said gains in home prices aren't sustainable in that households shouldn't take on significantly more mortgage debt because interest rates will have to rise soon.

Macklem added that the rapid increases (more than 30%) in home prices were abnormal. The central bank warns of intensifying debt vulnerabilities. Speculative activities are also causing a surge in housing prices. I wrote recently that the near-zero interest rate might end by the second half of 2022 at the earliest.

The downside

Economists, including **CIBC** Deputy Chief Economist Benjamin Tal, agree that it's the number one concern today. They contend that higher borrowing costs could affect the housing market. The immediate impact of higher interest rates is that loans become more expensive.

Canadians with large mortgages will carry a heavier burden. "An increase of 1.5 percentage points could double the monthly mortgage payments of some borrowers," said Tal. Some financial advisors suggest changing from an open mortgage to a closed mortgage so that interest rate changes won't affect the loan.

First alternative

A higher interest rate has an upside, too, particularly on savings accounts, fixed-rate investments, and even GICs. But for real estate investors, hold off buying properties while the situation is fluid. A real estate investment trust (REIT) like **Crombie** (TSX:CRR.UN) is an alternative investment if you want exposure to the sector.

Empire Company (TSX:EMP.A) has a 41.5% equity interest in the $2.99 billion diversified REIT. Crombie's income-producing properties nationally consist of high-quality grocery and drug store anchored shopping centres. It also includes freestanding stores and mixed-use developments. The locations are in urban and suburban markets.

About 57% of the tenants in the 228 properties are necessity-based retailers. Empire is the largest tenant and contributes 56.9% of the total annual minimum rent (AMR). Empire's lease expires in 12.9 years, while CIBC has 11.8 years left in its lease contract with Crombie. If you were to invest today, the share price is $18.08, while the dividend yield is 4.92%.

Second alternative

Dividend-payer **Timbercreek Financial** (TSX:TF) is among **TSX**'s solid performers in 2021. The stock is up 18%. Also, at $9.75 per share, the dividend yield is a juicy 7.08%. You'll have indirect exposure to the real estate sector if you invest in this $794.2 million company.

Timbercreek is a non-bank lender but provides financing solutions to commercial real estate investors. The lending program is unique and highly structured. Loan terms do not exceed five years, and therefore, the turnover rate is high. Similarly, the loan-to-value ratios are high, so the returns are inflation-protected.

In Q2 2021 (quarter ended June 30, 2021), net income increased 15% to $13.5 million versus Q2 2020. Notably, 92% and 89% of net mortgage investments are first mortgages and cash-flowing properties. Timbercreek CEO Blair Tamblyn said, "The portfolio continues to perform well, and transaction activity was solid against an improving backdrop for commercial real estate transactions."

Prepare for the inevitable

The historic low interest rate (0.25%) remains to this day as the Bank of Canada needs to cushion the impact of the pandemic-induced economic crisis. Still, Canadians must prepare for the inevitable. However, the timetable could extend because the economy shrunk in July due to slowing housing activity.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

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2. TSX:EMP.A (Empire Company Limited)
3. TSX:TF (Timbercreek Financial Corporation)

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