High Borrowing Costs in 2022: Buy a Home or Rent?

Description

Higher interest rates are indeed coming in 2022. The Bank of Canada announced the end of its quantitative easing program recently. BOC Governor Tiff Macklem intimated the multi-year inflation rate will stay longer before returning to the central bank's 2% target in late 2022.

Pandemic-related supply chain disruptions and higher energy prices are pushing prices higher. The only recourse available to cool down inflation is to increase interest rates. Sri Thanabalasingam, an economist with **Toronto- Dominion Bank** said, "Inflation is heating up. We expect BOC to raise rates three times next year, taking the overnight rate to 1% by the year-end 2022."

Homebuyers beware

Benjamin Tal, a senior economist at CIBC, advises Canadians to prepare for sooner than later interest rate hikes. He said the low-interest-rate environment is not normal and more of an emergency due to the pandemic. "The rates will eventually rise," he added.

Tal wants homebuyers to think before buying a huge house with a huge mortgage. The current 25 basis points might rise to 1.5% or 2%. He asks, "Can you afford this mortgage if rates are 10, 150, or 200 basis points higher? Because the increase would be significant over time, Tal suggests buying a smaller house or renting instead.

Investment prospects

Real estate investment trusts (REITs) are alternatives for people who want exposure to Canada's real estate sector. **Canadian Apartment Properties** (TSX:CAR.UN,) or CAPREIT and **Killam Apartment** (TSX:KMP.UN) are two of **TSX**'s steady performers as 2021 winds downs. The cash outlay is smaller, and you'll receive recurring income streams like a true landlord.

Largest provider of quality rental housing

CAPREIT has a market cap of $10.59 billion and is Canada's largest provider of quality rental housing. At $61.26 per share (+24.85% year-to-date), the dividend offer is 2.37%. This fully internalized growth-oriented REIT owns investment freehold interests in multi-unit residential properties. The assets include apartment buildings and townhouses. You can find them close to major urban centres across the country.

Despite the market changes and heightened risk environment, management said CAPREIT has a strong financial position. After the first half of 2021, CAPREIT's 5% and 6% growths in operating revenues and net operating income (NOI) versus the same period last year indicate stable leasing activities. The overall portfolio occupancy is high at 97.2%.

Top-line growth to continue

Killam is smaller than CAPREIT but is also growth-oriented. This $2.55 billion REIT owns, operates, and develops apartments and manufactured home communities (MHCs). On the stock market, it outperforms the broader market year-to-date, +38.81% versus +23.07%. At $23.14 per share, the dividend yield is 3.02%.

After three quarters in 2021, Killam's property revenues and NOI were 10% and 11% higher compared to the same period in 2020. The weighted average portfolio occupancy as of September 30, 2021, is 97.4%. In the back half of 2021 and beyond, management expects top-line growth to continue.

Consider higher interest rates

CIBC's Tal isn't sure to what extent higher interest rates will kill the consumer. He understands the danger that new buyers will take on a disproportionate amount of risk versus Canadians with existing mortgages, saying that consumers must start thinking about higher interest rates because they are victims more than anyone else.

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