Rent or Own? Higher Home Prices and Interest Rates in 2022

Description

Bank of Canada's rate-hike cycle will not only curb rising inflation but also cool down the red-hot housing market. Unfortunately, homebuyers face twin threats instead of one. Besides the forecasted 14.3% national average home price growth, economists predict the Feds will increase its key interest rate by three or more times this year.

Statistics Canada reports that the ratio of household debt to disposable income hit a record level in Q4 2021. It noted that mortgage borrowing rose, while disposable income fell. The level of household debt could be more alarming in 2022.

Despite the tapering home sales to start 2022, the Canadian Real Estate Association (CREA) expect price growth to continue setting records. Thus, besides the ongoing supply crisis, higher interest rates will impact housing markets from 2022 to 2023.

Rent or own?

Would-be homebuyers should evaluate their options carefully. Because of inflated home prices and higher mortgage payments, renting instead of buying might be a practical option to avoid undue financial risks. The situation today is doubly frightening, as prices of commodities are rising sharply. Moreover, an energy crisis is a possibility.

The prediction of analysts surveyed by Bloomberg Economics is an overnight rate range between 1.75% and 2.75%. If every increase is a quarter-point, the total rate hikes would be nine by the end of 2023. As early as November 2021, **CIBC** senior economist Benjamin Tal warned homebuyers to think before buying a huge house with a huge mortgage.

For real estate investors, the alternative option to purchasing physical properties is a real estate investment trust (REIT). The residential sub-sector, in particular, should be attractive if more Canadians choose rent over purchase. **Morguard North American Residential** (TSX:MRG.UN) and **Killam Apartment REIT** (TSX:KMP.UN) can provided rental-like income.

High-quality residential properties

Morguard focuses on high-quality multi-suite residential properties in Canada and the United States. The $1.14 billion REIT 43 properties with 13,275 income-producing suites. As of year-end 2021, the occupancy rates in Canada and the U.S. are 93.6% and 96.3%, respectively.

While revenue and net operating income (NOI) last year fell 1.3% and 4.5% versus 2020, net income climbed 46.9% to $244.97 million. As of February 15, 2022, the rental income collection in Canada and across the border remains strong, or more than 99% on average throughout 2021.

Morguard trades at $20.21 per share (+14.9% year to date) and pays a 3.51% dividend.

Largest development completions

Killam Apartment owns, operates, and manages apartments and manufactured home communities. In 2021, the $2.61 billion REIT reported 11.2%, 11.8%, and 95.5% increases in revenue, NOI, and net income, respectively, versus 2020. Its president and CEO Philip Fraser said, “We achieved strong financial and operational performance, realizing the positive results of executing on our three strategic priorities.”

Fraser added that Killam is maintaining a positive momentum. He said that 2022 will mark the largest year of development completions in the REIT’s history. Management expects more developments to contribute to earnings and net asset value growth for many years. At $21.80 per share, the dividend offer is 3.17%.

The historically low interest rate is history

The era of the low-interest-rate environment is over. Furthermore, multiple rate hikes could worsen the affordability crisis in Canada’s housing market.

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