Bank of Canada’s Higher Interest Rate Impacts Real Estate

Description

The Bank of Canada raised interest rates yesterday. Considering how overleveraged Canada’s economy is, this move could have a drastic impact in the months ahead. Much of this impact could be observed in the country’s biggest economic engine — real estate. If you own real estate or investment trusts in your portfolio, here’s what you need to know.

Bank of Canada’s strategy

The Bank of Canada has launched its most aggressive rate-hike policy in decades. For years, the key interest rate was held at 0.25%. Earlier this year, the central bank raised it to 0.50%. Yesterday, it doubled it to 1%. That’s the biggest spike since May 2000.

And the central bank isn’t done yet. In its publications after the announcement, the Bank of Canada has indicated that it expects inflation to remain elevated for the rest of 2022 and perhaps into 2023. To tame this wave, interest rates need to rise higher. That means we could see another 0.50% move in the next meeting on June 1.

Rising interest rates impact everyone. It raises the cost of debt for the government, corporations of all sizes, and even average households. Understanding this impact is the key to making the right investments in the months ahead. Here’s how to play this trend.

Risky real estate

Residential real estate across the country is staggeringly overvalued. On the basis of price-to-rent or price-to-income ratios, Canada’s homes are more overvalued than comparable homes in New York or London, United Kingdom. That’s unsustainable.

House prices have been kept afloat by cheap debt. But if interest rates are rising it could dent home buying demand. Meanwhile, the rising cost of essentials like food and fuel is already putting downward pressure on household income. Put simply, residential real estate is at risk.

Real estate investment trusts (REITs) like **CAPREIT** (TSX:CAR.UN) could bear the brunt of this downturn. The company is overexposed to residential real estate. The company owns and manages over 65,000 suites and development sites across major cities in Canada (and some in the Netherlands).

The company's book value could take a hit if Canada's housing market corrects. Meanwhile, the company's ability to service its debt of $6.45 billion could come under pressure as rates rise. If we dip into a recession, rental income and cash flows could also be impacted. Investors need to watch this trend closely.

Undervalued real estate

Canada's real estate bubble doesn't extend to all sectors and cities. Residential real estate in Alberta, for instance, is arguably undervalued and could find more support as the price of crude oil remains elevated. Meanwhile, commercial real estate has lived through a severe downturn and could have less downside risk than the housing market.

A commercial landlord like **RioCan REIT** should be on your radar if you're looking for a real estate bet despite the rising-rate environment. That being said, avoiding the real estate sector altogether may not be such a bad idea this year.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
2. TSX:REI.UN (RioCan Real Estate Investment Trust)

PARTNER-FEEDS

1. Business Insider
2. Koyfin
3. Msn
4. Newscred
5. Quote Media
6. Sharewise
7. Smart News
8. Yahoo CA

PP NOTIFY USER

1. kduncombe
2. vraisinghani

Category

1. Dividend Stocks
2. Investing

Date
2025/07/03
Date Created
2022/04/14
Author
vraisinghani