Canada Housing Is Insanely Overvalued: Avoid REITs?

Description

Canadians hoping to make their first home purchases lament the expensive real estate in the country. Moody's Analytics said that prices in urban cities were overvalued by 22.9% in Q4 2021. The situation didn't improve in Q1 2022 in that the affordability crisis persisted.

The Bank of Canada started its rate-hike campaign in March 2022 to curb inflation and cool the housing market at the same time. But in the same month, the MLS Benchmark Price of $887,100 was 27% higher than a year ago. The inflated selling prices are also deal busters for real estate investors.

If you want exposure to the real estate sector but are not inclined to pay more, take the indirect route. Real estate investment trusts (REITs) are distinct asset classes, where you can invest in specific types of real estate without owning physical property.

However, investors fear that rising interest rates could impact the performance of real estate stocks. Also, if it will lead to poor returns, should investors avoid REITs?

Housing market update

Kevin Crigger, president of the Toronto Regional Real Estate Board (TRREB), said, "Based on the trends observed in the April housing market, it certainly appears that the Bank of Canada is achieving its goal of slowing consumer spending as it fights high inflation."

Unfortunately, slower sales will not immediately bring down prices because market conditions remain tight. TRREB Chief Market Analyst Jason Mercer added, "It is anticipated that there will be enough competition between buyers to support continued price growth relative to 2021, but the annual pace of growth will moderate in the coming months."

Positive for REITs

Some real estate experts say that rising interest rates and inflation are positives for REITs and not the other way around. They further said that the assertion that REITs underperform when interest rates rise is a misconception. Moreover, real estate owners or landlords can increase rents during inflationary periods.

If you're investing in REITs, take positions in safe sub-sectors or high-demand properties. **Dream Industrial** (TSX:DIR.UN) in the industrial sector is the standout today. The $3.49 billion REIT owns, manages, and operates 244 industrial assets (358 buildings) in key markets in Canada, Europe, and the United States.

The compelling reasons to invest in Dream are organic & external growth, development pipeline, and development partnerships. You can add a strengthening balance sheet and enhanced liquidity. In Q1 2022, net income and net rental income increased 364.9% and 40% versus Q4 2021.

Brian Pauls, Dream's CEO, said, "Despite higher inflationary pressures putting upward pressure on interest rates, industrial fundamentals have continued to strengthen and we believe that there is a long runway for rental rate growth across all of our markets."

The REIT's total return of 41.20% (12.16% CAGR) in 3.01 years indicates stability. At the $13.90 per share, the dividend yield is an attractive 4.68%. You can earn passive income from Dream with a smaller cash outlay.

REIT characteristics

Canada's housing market is indeed overvalued but should correct soon. Meanwhile, investors should consider REITs for diversification, passive income, and inflation protection.

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