Home Prices Could Drop 10% if Sales Fall Below Pre-Pandemic Levels

Description

Canada's housing market is starting to cool, but homebuyers won't rush their purchases. Even if sales transactions have slowed down in major cities last month, higher interest rates and inflated prices are deal busters. **RBC** economist Carrie Freestone said, "All evidence points to the Bank of Canada's rate-tightening cycle starting to have an impact."

Freestone added that the decline in sales and slowing home price growth indicates a market shift. The 6.4% price drop in the Toronto market was the most significant since 2020. According to Capital Economics, rising borrowing rates could trigger a 10% slide in home prices over the next year before an even bigger drop in real estate investment.

Stephen Brown, senior Canada economist at Capital Economics, said, "With sales plunging, it is no longer a question of whether house prices will fall, but rather how much will they fall by?" He believes a 10% drop in home prices is possible if home sales drop 25% below the pre-pandemic average from 2019.

Sensitive to interest rates

According to Brown, the central might be underestimating the sensitivity of real estate investors to interest rates. Also, based on current market expectations, the rate hikes are too aggressive. Capital Economics expects the Feds to pause its tightening cycle if the policy rate hits 2.5% later this year.

Brown added, "If house prices were to fall by much more than we expect, the bank would loosen policy in 2023," However, he doubts interest rates returning to 0.25%, because it could reignite the housing cycle all over again.

Affordability crisis

The housing affordability crisis persists, despite two rate hikes already. First-time homebuyers in particular are in a dilemma, because costs are rising but home prices remain incredibly high.

Speculators and bidding wars drive prices higher. Finding the right home at a reasonable price in an ideal location has become extremely challenging.

Sellers have to set realistic listing prices also to generate interest for their properties. Many prospective home seekers hope the market imbalance corrects soon and lead to a buyers' market. Meanwhile, the federal government vows to implement new measures, like a foreign ban on ownership to ease the crunch.

Options for real estate investors

On the TSX, the real estate sector is down 18.62% year to date. Most real estate stocks also declined to start the week of May 9, 2022. However, despite the underperformance, real estate investment trusts (REITs) are the next-best alternatives to buying real estate investment properties.

Among the top picks this month is **Canadian Tire REIT** (TSX:CRT.UN), or CT REIT. This $3.92 billion REIT owns and operates income-producing commercial properties across Canada. The real estate stock trades at only $16.82 per share but pays a hefty 4.85% dividend.

In Q1 2022, property revenue and net income increased 1.6% and 24.8% versus Q1 2021. Its CEO, Ken Silver, said, "CT REIT's growth and resilience drove strong results in Q1, reflecting the core attributes of our strategy and business model." At the quarter's end, the occupancy rate is a high 99.3%. **Canadian Tire** is the anchor tenant.

Don't stretch your limit

Financial advisors caution homebuyers not to stretch their limits. Currently, housing costs outpace household income. According to real estate experts, supply must increase for home prices to stabilize.

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