Real Estate Investors: Sell or Hold as the Correction Draws Near?

Description

Royal Bank of Canada recently downgraded the forecast for the national housing market. With the new interest rates pressuring mortgage affordability, and variable rates jumping closer to the fixed rates, the largest bank in Canada is expecting an extremely aggressive correction. The predicted 42% decline from the 2021 peak in the home resale numbers is even higher than the 38% during the Great Recession.

The Canadian housing market was overinflated, even before the pandemic and the low-interest rates, which made borrowing much easier and accelerated the market to a dangerous pace. The housing bubble grew disproportionately higher, and now that it's about the pop, it would be on a scale similar to the 2020-2021 growth.

But what does it mean for investors? Should they sell their real estate assets to realize the gains before the market normalizes the prices for years to come? Or should they hold and wait to see how the market performs after the current "cool-off" period is over?

There is no easy answer to these questions, especially when we have yet to see the full extent of the correction. The actual resale numbers staying under or overshooting the RBC prediction might give people more information to work with.

The largest REIT in Canada

Canadian Apartment Properties REIT (TSX:CAR.UN) in Canada is worth considering as an investment, even in the current housing market, for more reasons than simply its title as the largest Canadian REIT. The first reason is its performance. It grew its market value well over 200% in the decade before the pandemic. That's about a 20% a year growth rate, which can double your capital in five years.

It's also a Dividend Aristocrat. And even though the yield is usually low because of the capital appreciation, it's currently at 3%, thanks to the 25% decline in the stock's value. The payout ratio hasn't even crossed 50% in the last decade, which is an endorsement of the financial stability of the dividend and its sustainability potential.

The REIT is currently both discounted and undervalued. Even though it may experience devaluation of its portfolio (residential properties), if the rents don't drop significantly, the REIT may pull through (financially). And the stock may remain stable and eventually start growing at its pre-pandemic pace.

Another apartment REIT

Killam Apartment REIT (TSX:KMP.UN) is a relatively smaller apartment REIT, both in market value and portfolio size. But the growth potential is quite similar to Canadian Apartment Properties. The Killam Apartment stock also grew about 100% in the five years preceding the 2020 crash, which is the same growth rate (in a bullish market).

It's also offering the same discount and nearly the same valuation, but the yield is much higher at 3.95%. The REIT has also been growing its payout at a steady rate for the past few years, and its payout ratios have remained quite stable since 2016.

Killam is a healthy real estate investment, especially at the current discount, for both its capital-appreciation potential and dividends. The current housing market may keep investors away from real estate assets, and REITs like Killam can help fill the gap.

Foolish takeaway

We may see a decline in real estate investing in Canada, considering that many of the "investors" tend to use financing to buy their assets. Now that the interest rates are higher than they have been in years, this is not a financially feasible option. But REITs, even residential ones like Killam and Canadian Apartments, remain viable options.

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