Canada’s Housing Market: Should You Be Worried?

Description

Canada’s housing market has been one of the hottest places for real estate investors for the better part of a decade. Despite several warnings of a significant downturn over multiple years, the housing market showed incredible resilience and enormous growth.

The economic impact of the pandemic should have technically catalyzed a downward correction in the housing market. However, the complete opposite happened. The government was reluctant to raise interest rates amid the pandemic to ease the financial burden. It also pumped liquidity into the economy through stimulus funds to help Canadians struggling with employment issues.

The combination of a low-interest-rate environment and greater savings due to lower discretionary spending resulted in an unexpected boom in the housing market. People started shopping for bigger homes as they were forced to stay at home.

The rise and fall

The situation has changed entirely in recent months. The world is moving into a post-pandemic era, inflation has gone through the proverbial roof, and central banks have been forced to introduce a series of interest rate hikes to curb the red-hot inflation.

The Canadian housing market was already overinflated before the pandemic. An easier ability to borrow funds for mortgages accelerated the market to dangerously high levels. The housing bubble was already getting close to catastrophic levels, and it seems that the pandemic boom might have pushed it past the point where it could sustain those growth levels.

The Bank of Canada (BoC) and the U.S. Federal Reserve have raised benchmark interest rates several times in 2022, and several more will likely follow to bring record inflation levels under control. **Royal Bank of Canada** recently downgraded its forecast for the national housing market due to higher mortgages impacting affordability.

Canada’s largest bank by market capitalization has warned Canadians to expect a historic downward correction in home prices due to reduced resale activity.

RBC's assistant chief economist, Robert Hogue, expects the market to see a cumulative 42% decline in home prices from its 2021 all-time highs. Such a downturn would exceed all the peak-to-trough declines in the four preceding downturns.

RBC expects the national benchmark price to decline by over 12% in the second quarter of 2023 alone. More declines could be on the way, as banks expect interest rates to rise to 3.25% by October.

Should investors stay away from real estate?

Purchasing a house as an investment property might not be the wisest move in the current environment. With further interest rate hikes likely on the way, mortgages will become increasingly cost prohibitive. A decline in home prices would only make matters worse. However, there might be a way to gain exposure to the real estate market and use it to your advantage.

People who would want to purchase homes as their primary residence but no longer can due to affordability, will likely be limited to living on rent. Real estate investment trusts (REIT) like **Canadian Apartment REIT** (TSX:CAR.UN) could benefit from such a trend.

CAP REIT is the largest Canadian REIT primarily engaged in acquiring and leasing multiunit residential rental properties in major urban areas across the country.

Headquartered in Toronto, the $8.29 billion market capitalization REIT generates its revenue through rental income from its properties leased out to tenants. Lower residential real estate prices could allow the company to add more properties to its portfolio.

Foolish takeaway

CAP REIT trades for $47.60 per unit and boasts a 3.15% forward annual dividend yield at writing. With a payout ratio of just 18.55%, CAP REIT looks well positioned to continue paying out monthly shareholder distributions without worrying investors about sustainability.

It is attractively priced at current levels, trading for a 24.16% discount from its 52-week high. It could be a good way to gain exposure to the real estate market as a lazy landlord to generate a passive income and long-term wealth growth through capital gains.

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