Canadian Housing Bubble: These REITs Are the Most Vulnerable

Description

There's simply no doubt: Canada's housing market is overpriced. Homes across the country cost too much, and citizens are struggling to afford their mortgages as rates rise. Economists now expect a severe correction in home prices over the next year. This could have an impact on some real estate investment trusts (REITs).

Here's what investors need to know.

Rising rates could plunge the housing market

Canada topped the list of most vulnerable housing markets in the world, according to the Economist Intelligence Unit. Meanwhile, Toronto and Vancouver topped the UBS Real Estate Bubble Index.

Canada's journey to the top of these lists was paved with cheap money. The central bank lowered interest rates to 0.25%, which allowed banks to offer variable mortgage rates as low as 2%. At these rates, the income required to qualify was significantly lowered. Effectively, more Canadians could buy more homes which pushed up prices.

Now, the trend is reversing. The Bank of Canada has delivered another 0.50% rate hike this week. The benchmark rate is now 3.75%. It could hit 4% soon. Meanwhile, the average mortgage rate is nearly 6%. Of course, home prices in nearly every major city has declined in recent months.

This impacts homeowners and speculators. But it also has a severe impact on commercial landlords and REITs.

Vulnerable REITs

REITs could face a decline in book value as the real estate market slumps. Meanwhile, these companies could also struggle to manage their debt, as interest rates surge. The pain could be too severe for some REITs.

Minto Apartment REIT (TSX:MI.UN) could be an example of this. The company's portfolio is heavily concentrated in Ontario, particularly Toronto, which is one of the most vulnerable markets right now.

A correction in home prices in these major cities could have an impact on the company's book value per unit. Meanwhile, rising interest rates could impact the company's expansion or borrowing costs.

Better REITs

Commercial REITs with exposure to the United States could be in a better position. **Slate Grocery REIT** (TSX:SGR.U) is a prime example. The company owns and operates a network of grocery stores across the U.S., most of which are anchored by major retailers such as **Wal-Mart** and **Krogers**.

Not only is the U.S. real estate market better positioned, but the grocery sector is much more recession-resistant than its peers. That puts Slate Grocery in a favourable position for the foreseeable future.

Meanwhile, the REIT continues to deliver an attractive 8% dividend yield. As rents rise, this yield could climb higher in the months ahead. Effectively, Slate REIT could be a hedge against inflation and help investors preserve wealth over the long term.

Canadian investors that are worried about rising interest rates, falling real estate prices, and inflation should add this stock to their watch list.

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