



Does Your Real Estate Strategy Need A Makeover?

By: Joe the Investor

The cost benefit proposition of owning real estate has changed dramatically over the last year. One year ago, interest rates were really low, prices were steadily climbing and the idea of buying real estate seemed affordable. Fast forward to today, and the mortgage rates have more or less doubled, and the price of residential real estate is down from 5% to 15% in most parts of Canada since March 1, 2022. On the other side of the equation, the rents have gone up significantly in 2022 as more homeowners become renters. The cost of renovation is also going up and is likely to continue to rise.

A Different Strategy

The idea that real estate prices never go down needs to be put to rest. It may go up in the long run, but there are down years similar to stocks, bonds and commodities. The idea of leveraging or borrowing a lot of money to buy real estate will not occur as frequently as it has up until now.

The strategy of buying something, renovating it and flipping it appears to be dead for the time being. The renovation costs are higher in general and there is a higher risk of delays than there was 3 years ago. The prices of materials are much more volatile making a renovation more risky than in the past. Interest costs for waiting on the renovation to be completed are also higher than in the past. The real estate prices going down are also making flipping real estate for a profit much harder to do. The one area where this can still be lucrative is if a place is bought that needs a lot of work, the renovations are done inexpensively and the value of the renovated place can be realized upon sale. A bonus would be if the updated place would command a high rent, as this would attract investment property seekers.

The one bright spot is having a property that is in high demand when it comes to rent. Rent in this case is longer term rental. Short term rentals are still precarious due to possible lockdowns and volatility in business activity. Longer term rentals are a type of recession hedge because the worse the housing market gets, the more people will have to sell, and these sellers will become renters. The high influx of renters will increase demand and raise the rents. The rentals in particular would have to be in areas where renting is preferred, like near Universities, near transit and transportation access, near parks and greenspace, or near shopping and work areas.

If you are new to real estate or want to buy more properties, you may have lower prices than in the last few years. The fly in the ointment is if you are borrowing large amounts of money to buy real estate. There is a possibility that interest rates may start to decline within the next 12 months. If this happens, lower interest rates combined with lower real estate prices may present an opportunity to acquire

something at a good price for lower borrowing costs. The timing has to be impeccable to pull this off, but it can be done. This strategy is also good if you are buying real estate with low debt or with cash.

The focus of this article so far has been on residential real estate. Commercial and industrial real estate have different dynamics at play because these types of real estate are typically for business owners and investors. Commercial real estate has been in a glut in the retail sector and office sector, but it is a mixed story for institutions and other forms of real estate. Industrial real estate has been the best place to be over the last 3 years due to a shortage of serviced properties and more demand due to the volatility of the supply chains. The notion of building more products locally is also creating more demand which will push prices higher in the industrial sector. The risks in commercial and industrial real estate arise from government policies and business risks. The pandemic has made operating a business much more uncertain, and holding expensive real estate is much more difficult due to the uncertainty of cash flows. The recent rise in interest rates has also made buying and holding more expensive compared to just one year ago. If you are looking to rent commercial or industrial real estate, the prices are much variable depending on the industry you are in and the local supply and demand economics. It pays to shop around and expand your network of possible locations to get a good idea of where the deals may exist. Rents will likely move higher due to property taxes and utilities, but sector supply and demand may dwarf these costs if there is large oversupply of space or a drying up of demand.

Real estate can still be a good investment, but the low hanging fruit is gone. Each property has to be purchased with more discernment than in the past.