Economic Commentary

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Economic Commentary: More weakness ahead for the Vancouver Metro Market

A price correction is underway in Metro Vancouver's homeownership market which should come as little surprise to anyone following the headlines.

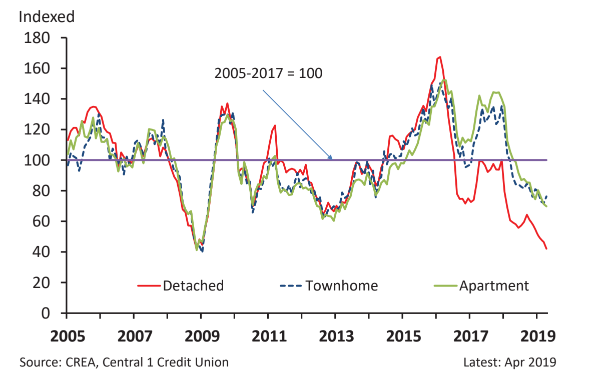
Metro Vancouver sales are trending at the slowest pace since 2012/13 and approaching levels last seen during the 2008/09 global financial crisis. This comes despite a relatively firm economic environment with minimal economic stress. Higher interest rates and various federal and provincial housing policies are weighing on sales activity. Year-over-year sales are trending at a -30% year over year pace in the early part of the year. Declines have been comparable across the detached and multi-family markets pointing to a broad negative shock in demand. That said, the decline from peak sales has been sharpest in the detached housing sector due in large part to severe erosion in affordability in 2016 followed by the introduction of the foreign buyer tax.

The severity of the housing market sales slowdown in the region has come as a surprise. While home sales have generally stabilized in other parts of Canada, the sales flow has continued to deteriorate in Metro Vancouver.

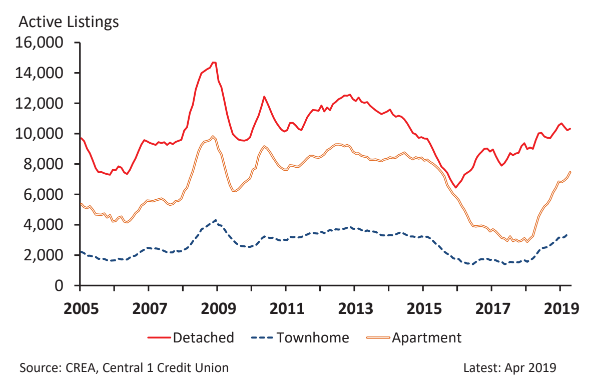
Declining home values reflecting the sharp downturn in demand and rising inventory. Sales to listing ratios declined rapidly through 2018 to retrench from a strong sellers' market, with the detached housing market firmly planted in a buyers' market. While ratios for apartment and townhome units remain at a level traditionally associated with balanced sellers' market conditions, the speed of descent matters, and indicative of a rapid shift in demand which has triggered price declines. Higher inventories primarily reflect low sell-through of units as the flow of new listings have remained steady.

Prices are in decline, although estimated magnitude is dependent on measure and data used.[1] The Lower

MLS® Lower Mainland Sales



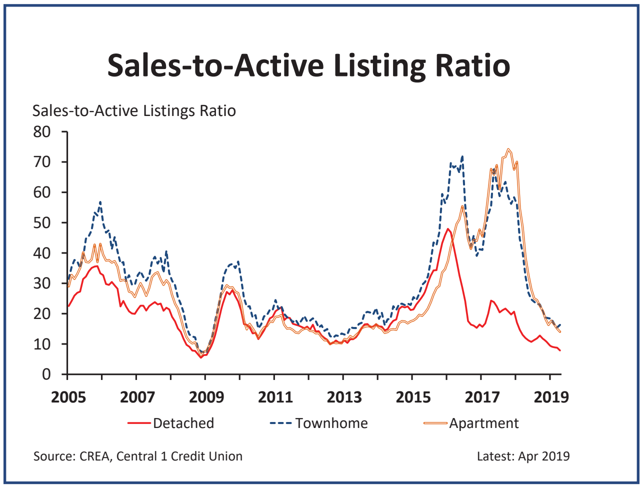
MLS® Lower Mainland Resale Inventory

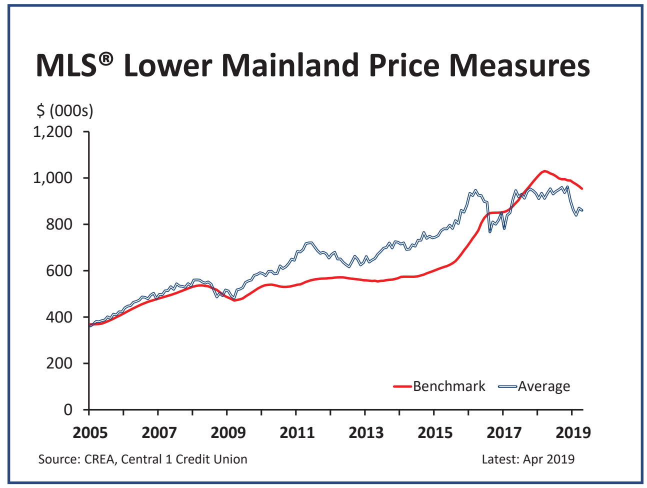


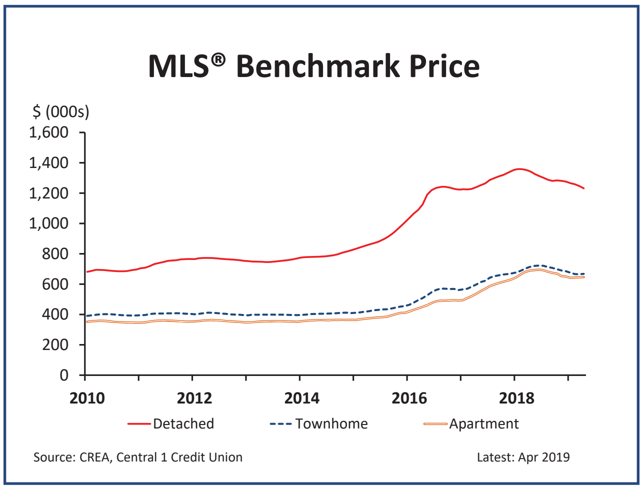
Mainland MLS® benchmark housing price index has declined about eight per cent since peaking in the first half of 2018. In contrast, the average home price in the region has declined just over ten per cent or $100,000 from peak. This gap in performance partly speaks to weaker market conditions in the detached market and luxury product as well as shifts in sales composition. That said, the benchmark typically lags the median and average price measures.

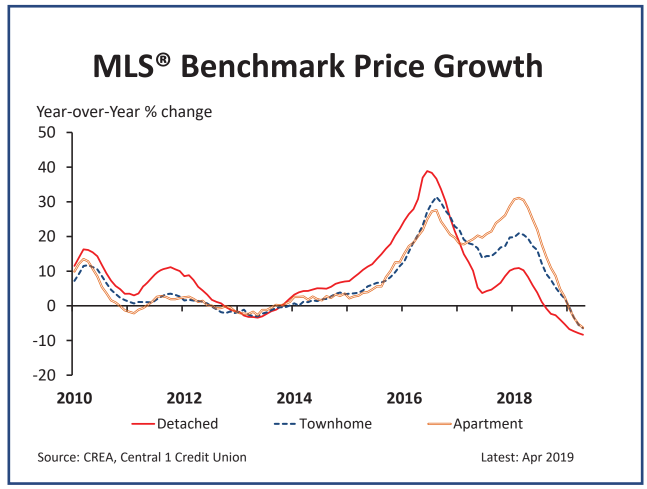
Home prices are in decline across product segments, with falling average, median and benchmark values. The benchmark detached home price has declined about eight per cent from a year ago, although townhome and apartment home prices are down roughly six per cent. These are roughly in line with declines from peak 2018. The average price story is generally aligned with benchmark trend, although

1 *We generally prefer to assess land title transfer data, which drives both the Teranet Housing Price Index and median due to geographical completeness that aligns with the Vancouver Census Metropolitan Area, it lags changes in market conditions as it reflects closing of real estate transactions rather than firm sales offers and acceptances. MLS® data is more timely, but geographically inaccurate. The Lower Mainland is the combined Real Estate Board of Greater Vancouver (REBGV) and Fraser Valley Real Estate Board (FVREB). The former covers much of Metro Vancouver and the Sea-to-Sky markets, but excludes key areas of the CMA such as Surrey, Langley, and White Rock. These markets are included in the FVREB, alongside Abbotsford-Mission CMA.*







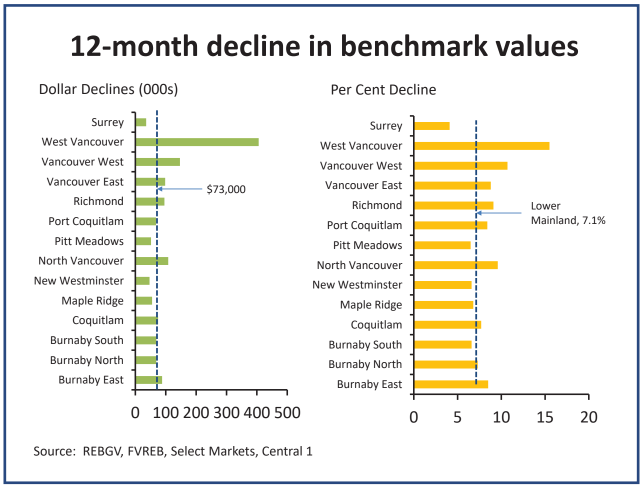


apartment condominiums appear to be falling more quickly, down 10 per cent year-over-year.

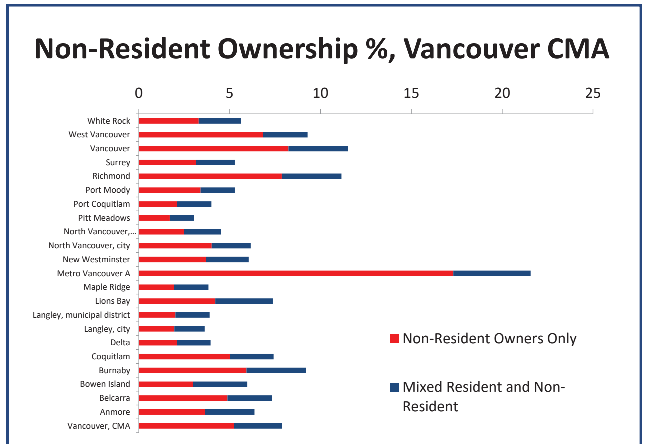
We are somewhat starved for detailed data from MLS® but regionally, there is a clear divergence in market conditions. Relatively more affordable markets have experienced firmer conditions. Year-over-year declines in the composite Home Price Index (HPI) for all properties in April was deepest in West Vancouver (-15 per cent), Vancouver West (-10 per cent), North Vancouver (-10 per cent) and Richmond (-9.6 per cent). Declines varied across most other municipalities but were generally in the six to eight per cent range. The declines are equivalent to about $400,000 in West Vancouver and $150,000 for Vancouver West. Headline detached housing price declines mask some divergence as markets north of the Fraser River fell broadly across regions by more than 10 per cent, with Fraser Valley declines more modest.

The current downturn is a climbdown from the substantial price gains in prior years. The low interest rate cycle, strong economic growth and immigration underpinned demand amid constrained housing supply. Over the decade from 2008 through 2018 the median resale value rose 70 per cent, with levels up more than 25 per cent since 2015. Shifting sales composition means this understates price growth, with detached prices more than doubling since 2008, and 70 per cent gains in the multi-family sector. In 2016, detached home prices surged 30 per cent.

Investor demand for real estate both from domestic and foreign sources in a low rate environment, coupled with a sharp depreciation in the Canadian dollar, likely contributed to higher prices. Detached home prices surged in 2015 and the first half of 2016, before temporarily peaking. Detached home values rose 30 per cent on a one-year basis, aligning in part with the sharp drop in the Canadian dollar and rise in foreign purchasing. The rapid erosion of affordability already curtailed sales flow before the announcement and implementation of the provincial government's 15 per cent foreign buyer tax. Mortgage stress tests for federally insured high-ratio (down payment of less than 20 per cent) were also implemented in October 2016, providing further downward pressure on activity. Buyers quickly pivoted towards more affordable options in the townhome and apartment market, lifting sales to near record-highs as detached home sales languished.



Source: REBGV, FVREB, Select Markets, Central 1



Source: Statistics Canada, Central 1 Credit Union

While market forces were already slowing the detached sector, interest rate hikes beginning in 2017 and further policy measures have driven what can be best described as a housing sector recession. Federal B-20 mortgage stress test measures swiftly cut purchasing power by up to 20 per cent for some buyers in January 2018. High priced markets, like Vancouver, were particularly impacted as it was difficult for buyers to bridge the gap in purchasing power through higher down payments in an already high priced market.

Provincial policies have also weighed on the demand cycle. Hiking of the foreign buyer tax from 15 per cent to 20 per cent and introduction of a speculation tax likely chilled demand on the high end of the market. Adding to this were additional school taxes on high-valued properties. More restrictive rent control policy has been an impediment for investor owned properties. The introduction of a beneficial ownership and pre-sale database were warranted to combat potential tax evasion be a factor in slowing demand.

These policies have largely slowed the market to recessionary levels but in the absence of an economic recession. In fact, the economy remains quite firm with strong employment growth, low unemployment, population gains and investment activity.

What's next?

This downturn in the regional housing market will extend through 2019. There are no signs at this point that the various policy measures will be reversed, pointing to ongoing demand-side weakness from both owner-occupiers and investors.

Money laundering in Vancouver has been shown to be an issue in the region, although as can be expected, estimates of the unmeasurable is fraught with uncertainty. Model driven estimates pointed to a $5.9 billion impact on B.C. real estate and a cumulative impact of about five per cent on prices. However, this was based not on local data, but estimated via general linkages of the size of economies, assumed global money laundering and crime rates, among other factors. We do not know the extent or impact of this on the market. That said, we would expect a public inquiry will feed through the market with real estate activity associated with money laundering declining, but broader buyer confidence rising.

Further price declines are expected. High levels of units under construction in the apartment and to a lesser extent, townhome markets, are expected to be a drag on prices. As of April 2019, there were 41,881 units under construction in the region, with nearly 34,000 units being apartment units. Roughly 60 per cent of all units under construction were freehold or condominium tenure. The vast majority of these are presold, which is largely a precondition for construction financing. What is unknown is the share of properties purchased for speculative or investment purposes. Assuming these units were unable to be sold as an assignment due to developer rules or thin market demand, we could expect listings to rise as projects are completed, which will drag on prices into 2020.

Declines in apartment and townhome prices will likely be deeper than detached homes going forward. The price correction phase in the detached market is more advanced, with market conditions slumping since 2017.

On the upside, firm economic conditions in Metro Vancouver and a rising population will remain a positive support for housing demand, albeit policy measures constrain purchasing power. Population growth will continue to drive demand for new housing in the region, although constrained by purchasing power. The strong economy will also curtail listings by existing homeowners who can be patient or are unwilling to sell at a lower price point. Modest inventory accumulation will stabilize home values.

We forecast a peak to trough decline in the Lower Mainland MLS® Housing Price Index of 12 to 15 per cent, suggesting another 5 to 7 per cent decline in this cycle. The annual median resale price for the Vancouver census metropolitan area (CMA) is forecast to decline seven per cent in 2019 and three per cent in 2020 to $670,000. There is more downside than upside risk. Prices generally trend range-bound for the next three years.

This downturn will be modest relative to previous downturns. Historically, home values have risen in Metro Vancouver although prices corrections—like the one currently observed—are hardly a rare occurrence. Median price data over the past 40 years show price cycles of varying magnitudes and longevity. The early 1980s saw rapid appreciation of more than 70 to 90 per cent over the short period of a year before declining 35 per cent during the subsequent year. The mid-to-late 1990s experienced a flat pricing environment, although a negative real contraction of about 20 per cent. The last significant bout of price contraction came in 2008/09 when prices declined 10-15 per cent, dependent on housing type.

In each instance, drivers largely differed. The 1980s correction coincided with a broad tightening of monetary policy to flush out inflation in the economy. Interest rates spiked, with three-month treasury yields doubling to 20 per cent in 1981. This preceded a severe recession in the economy. The stagnant environment in the late 1990s coincided with modest growth in the economy, but the regional housing market was negatively impacted by the 'leaky condo crisis' and a downturn in confidence; the return of Hong Kong–Canadian residents to Asia following the 1997 handover to China; and, effects of the Asian Financial Crisis. This was followed by the tech bust in the early 2000s. The strong price cycle observed since 2000 was cut short by the 2008/09 global financial crisis, but deep cuts to interest rates shored up demand.

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