Is Vancouver's Housing Market Really Overvalued?

Description

Nothing garners more attention than claims that a massive housing bubble triggered by rampant foreign investment has made housing unaffordable for the average Canadian and is on the verge of bursting. These are the claims being made about Vancouver's scorching hot housing market, and with the average house price for July 2016 rising by 15% year over year, according to the MLS Home Price Index, it is easy to understand why.

However, there are signs that these fears are overbaked and indications that higher housing prices may be the new normal.

Now what?

The first point to consider is that housing demand in Vancouver continues to grow. This is because its population is growing at a brisk pace. The city is one of the preferred destinations for both internal and external migrants.

Along with Toronto, Vancouver is responsible for accepting about half of all external migrants to Canada, and it's easy to see why.

The majority of Canada's jobs growth is occurring in those cities; data from **Bank of Montreal** shows that they were responsible for all Canadian jobs growth during 2015. This trend continues with recent data showing that Vancouver is the strongest jobs market in Canada with unemployment hitting a seven-year low of 5.4%–more than a full percentage point below the national rate.

The prolonged slump in crude, which brought the oil boom to an abrupt halt and cast Alberta into its longest economic slump since the 80s, has led to a sharp increase in the volume of internal migration. Many of those migrants are moving to Vancouver because of its impressive jobs growth.

These factors are causing demand for housing to surge, but another important consideration is the lack of supply. The inventory of available housing and land for development is extremely limited.

Typically, housing inventories over the short to medium term are rather inelastic, usually taking a

considerable amount of time for them to adjust to demand. This is quite clear in Vancouver, where the residential housing inventory is currently at 40% of its 10-year average, meaning there is insufficient housing to meet demand.
There are signs that this shortage won't be filled anytime soon.

The amount of land available for urban development in the Vancouver metro area is restricted, and because of policy and geographical constraints, it is unlikely that it will expand sufficiently to meet the demand for residential development. This becomes clear when considering that data from Statistics Canada shows that the amount of land in the Vancouver metro area barely grew between 1981 and 2011.

So what?

There is no question that Vancouver's housing market is red hot and that prices have experienced an unprecedented rate of growth over the last decade, leading many to claim it is in the midst of an epic bubble. That said, it should be considered that because of swelling demand and constrained supply, the market could be in the process of finding a new equilibrium where significantly higher prices are the new normal.

Nonetheless, such a blisteringly hot market should be regarded with caution. There is still a considerable degree of uncertainty surrounding the direction of prices, and the downside risk remains huge. Canada's third-largest mortgage lender **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), in recognition of this risk, has decided to dial down its lending activities in Vancouver.

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