Betting on a Hard Correction in the Vancouver Real Estate Market? Don’t Hold Your Breath

Description

According to the **MLS Home Price Index**, the median price for a single detached home in the Greater Vancouver Area slipped to $1,511,100 in November–down 2.2% from the month prior. Although correction forecasts have been spectacularly wrong, as prices for detached homes surged 63% over the past three years, 2017 might actually be the year we see the long-awaited pullback. That being said, I’m expecting a soft landing rather than a hard correction, as Vancouver’s housing supply remains subdued.

Foreign demand cooling

Although it’s too early to gauge the effective of the foreign buyers’ tax, there have been some signs that foreign demand for Vancouver homes might be cooling. As reported by *Bloomberg*, since the implementation of the tax, searches for Vancouver properties on Chinese real estate sites have plunged in the wake of the tax.

bloomber-chinese-real-estate-inquiries
Foreign interest cooling (Source: Bloomberg).

Furthermore, I see sharper declines in foreign investment into Vancouver as China ramps up efforts to reduce its record volume of capital outflows. One such recently adopted measure, according to **Reuters**, was the vetting of transfers abroad worth $5 million or more, and the increased scrutiny of major outbound deals.

Tighter credit conditions

It’s not just foreign demand that is starting to wane. It goes without saying that current home prices are woefully out of reach in Vancouver given the current levels of median income. Moreover, the sky-high housing prices combined with the federal government’s proposed changes to mortgage lending rules, such as a higher minimum down payments and reduction of the maximum amortization period from 40 to 25 years, will also contribute to a cooling of property values.

housing-vs-median-income

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A startling disconnect between the home prices in Vancouver and Toronto, and the median income (Source: Bloomberg).

I'm anticipating that demand for housing stemming from the increase in net B.C. migration will also begin to slow as Canada's oil patch begins its recovery.

Higher interest rates

On Wednesday, the U.S. Fed hiked the benchmark rate by a much anticipated 25 basis points with the possibility of an additional two to three hikes in 2017 to combat the threat of rising inflation. While the Bank of Canada has maintained the overnight rate at 50 basis points for now, I believe that longer-term bond yields will rise in tandem with U.S. interest rates and domestic inflationary expectations.

govt-canada-bond-yields

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Bond yields are expected to rise after the elections (Source: BCREA/ Bank of Canada).

mortgage-rate-forecast

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Mortgage rates will also tick up (Source: BCREA/ Bank of Canada).

But supply is still subdued

On the supply side of things, housing starts have surged over 30% this year in B.C. and, after dipping in August and October, are back above the six-month moving average for November. The much-needed supply will also be coming up against higher vacancy rates stemming from Vancouver's newly announced empty homes tax. The tax, which will be implemented in January 2017, will penalize home owners into renting out their vacant homes at an annual rate of 1% of the assessed value of their homes. However, as it stands, the tax is largely based on self-reporting and is difficult to enforce.

That being said, overall supply remains largely inadequate due to restrictive zoning rules (for example, a quarter of Metro Vancouver's land is set aside for agricultural use) and lack of demand for multi-family units. Moreover, the consensus estimates see a moderation in housing starts for 2017 as builders look to complete existing construction.

So, while the demand side of the equation is being addressed, supply is still the biggest elephant in the room, and until Vancouver embraces much-needed residential developments, the city's housing market will remain resilient to a hard correction.

In the meantime, it's wait-and-see mode to learn what effects the demand-side measures will have on Vancouver's housing bubble. For the time being, it might be more prudent to invest in this hot market via a REIT with Vancouver exposure, such as **Canadian Apartment Properties REIT** (TSX:CAR.UN).

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