THE UA TAKE – FIRST QUARTER 2019:

MARKET ON PAUSE… SORT OF

Finance Minister Carole James says the goal of her budget's new housing taxes is a downturn in the market and a drop in home prices…

(Vancouver Sun - February 2018)

When a government clearly states it is introducing policies to slow the housing market and lower prices, it stands to reason consumers will hit the pause button on their new home purchase to see if lower prices will in fact ensue. And that is exactly what has occurred in Metro Vancouver's housing market over the past year; while many purchasers recognize the opportunity current market conditions present *(more on that later)*, a larger proportion of would-be homebuyers are sitting on the fence waiting to see if the market will drop further. Given the unrelenting headwinds and storm clouds battering the residential market in Metro Vancouver over the past 12 to 18 months, most of them the result of numerous government policies and rhetoric that appear intent on tarring an industry that is among the largest contributors to employment and tax revenue, the fact the new multi-family home sector recorded the third lowest quarterly sales total since 2010 in the first quarter of 2019 should surprise no one. It will be interesting to observe how these different levels of governments react as they begin to feel the impact on their revenues of the dramatic drop in market activity.

James admitted her Finance Ministry has not done any modelling on how much the market could adjust because of her measures.

(Vancouver Sun - February 2018)

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Not surprising given the sophistication of the new home market in Metro Vancouver, many developers and other stakeholders have adjusted to the more challenging market conditions by postponing the launch of projects that had been scheduled to commence sales in the first quarter. The lower projected revenues combined with high construction costs and the plethora of municipal and provincial government fees and taxes made many projects unviable. While some of the limited sales activity can be attributed to the fewer new project launches, the postponement of these projects will keep the inventory of unsold units from growing to concerning levels.

Unlike the previous market downturn of 2008 and 2009 when buyer paralysis ensued for several months as everyone waited to see what would transpire in the wake of a global financial crisis, current market fundamentals remain very positive in Metro Vancouver's housing market. The economy continues to grow (albeit at a much slower pace), employment remains at near record levels and by all accounts, there are still plenty of prospective end-user buyers seeking opportunities. New multi-family home project representatives throughout the market report steady traffic and buyer interest. The most notable element currently missing in the market is urgency; prospective buyers recognize they now have time to make a buying decision and are taking full advantage. Most buyers are now paying multiple visits to various project presentation centres before making a buying decision.

While current market conditions are more challenging for developers, they present an opportunity for buyers. Completely warranted laments about condominium and townhome projects being substantially sold out prior to a public launch, the emergence of the FOMO (fear of missing out) factor that led to rushed buying decisions, and steadily rising prices were constant from those looking to purchase a home over the past several years. While new home prices remain high relative to the previous decade, current market conditions are more favourable than they've been for years; interest rates remain near record lows, prices have dropped at least 10 percent from the market peak, and developers are offering higher valued incentives that reduce prices further. The greater urgency for developers to sell their inventory (i.e. preselling projects trying to meet presale targets), the greater value buyers are likely to realize.

Projects counting on demand from investor purchasers to help meet presale requirements have felt the greatest impact from the changed market conditions, as this buyer group is more apt to stay on the sidelines and wait for what they perceive as the bottom of the market. Developers of these projects have been more inclined to postpone marketing launches, indefinitely in some cases.

In the absence of a crystal ball, it is of course extremely challenging to determine how long current market conditions will persist and when buyer sentiment will turn more positive. History has shown consumers require some sort of trigger such as a government change, a sign of the market's bottom or a sense that prices have flattened and are not likely to drop further to experience a shift in their sentiment. With little likelihood of a provincial election on the horizon and minimal impact expected from this fall's federal election, the latter is the likely scenario that will initiate more positive consumer sentiment. As current year-over-year MLS statistics indicate a substantial drop in sales and lower sale prices relative to the same month in 2018, it will likely take until the second half of this year for these monthly statistics to be more comparable to the previous year. As such, it may take several months of these comparable year-over-year monthly statistics to convince buyers (investors in particular) the market has stopped falling and has stabilized sufficiently for them to get off the fence and commence buying again.

What continues to be especially concerning is the lack of acknowledgement by any level of government of the impact the multiple levels of fees, charges and taxes, and delays in approving new projects on housing affordability. UA maintains there needs to be far greater willingness for government and industry to engage in constructive discussions to find solutions that will prevent the frenzied market conditions of the past few years from occurring again. These solutions must include policies that address the pace of new multi-family home development approvals to ensure there is sufficient supply to meet whatever demand levels exist during a given period.

The following is an analysis of sales activity in the first quarter of 2019 and a comparison to previous quarters and years, along with a review of the inventory trends through the first three months of the year.

Sales and Inventory Analysis

The number of new multi-family home sales recorded in the first quarter of 2019 represents the third lowest quarterly total since 2010. The 1,783 new condominium and townhome sales in the first quarter of this year represents a 56 percent drop from the total recorded in the last quarter of 2018 and is 61 percent lower than the 4,514 units sold in the same quarter last year.

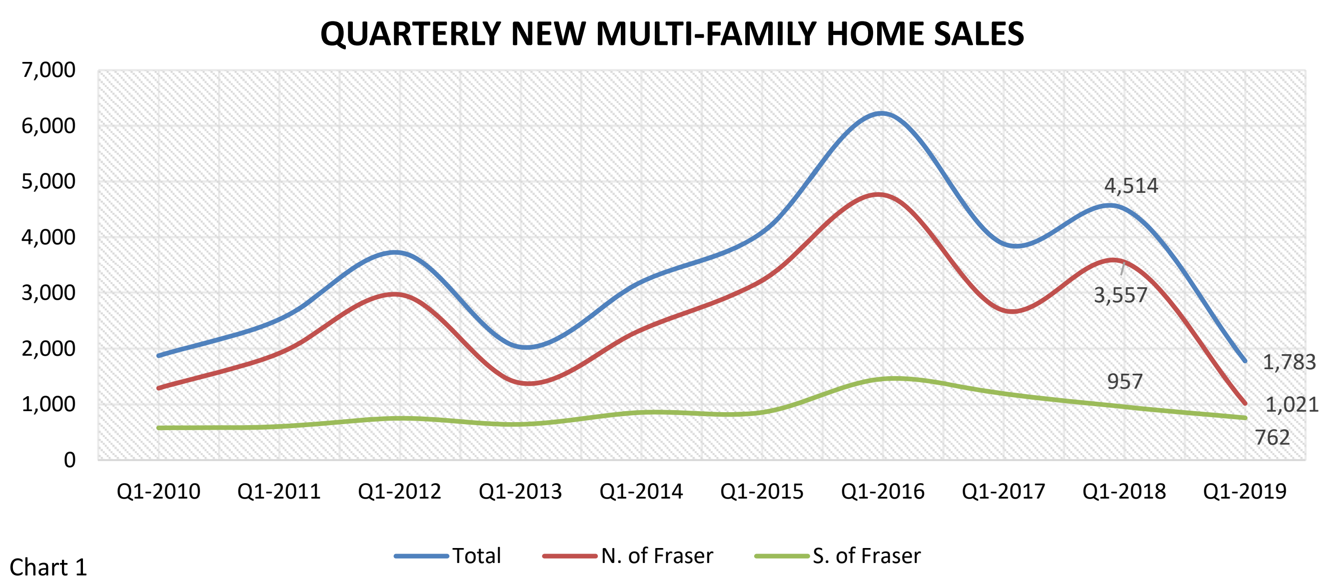

Chart 1

As illustrated in Chart 1, the most significant drop in sales occurred in the more urban North of Fraser sub-markets. South of Fraser sub-markets experienced a more modest 20 percent year-over-year drop.

Whereas sales activity in the last quarter of 2018 benefited from the launch of several new concrete condominium projects, the opposite was the case in Q1-2019. That is, the postponement of the marketing campaigns of several comprehensive new multi-family home projects during the first quarter contributed to the substantial drop in unit sales. Chart 2 illustrates the wide variance in the number of projects launched and units released in the first quarter of previous years compared to this year. It also illustrates the general correlation between sales and the number of units released in a given quarter.

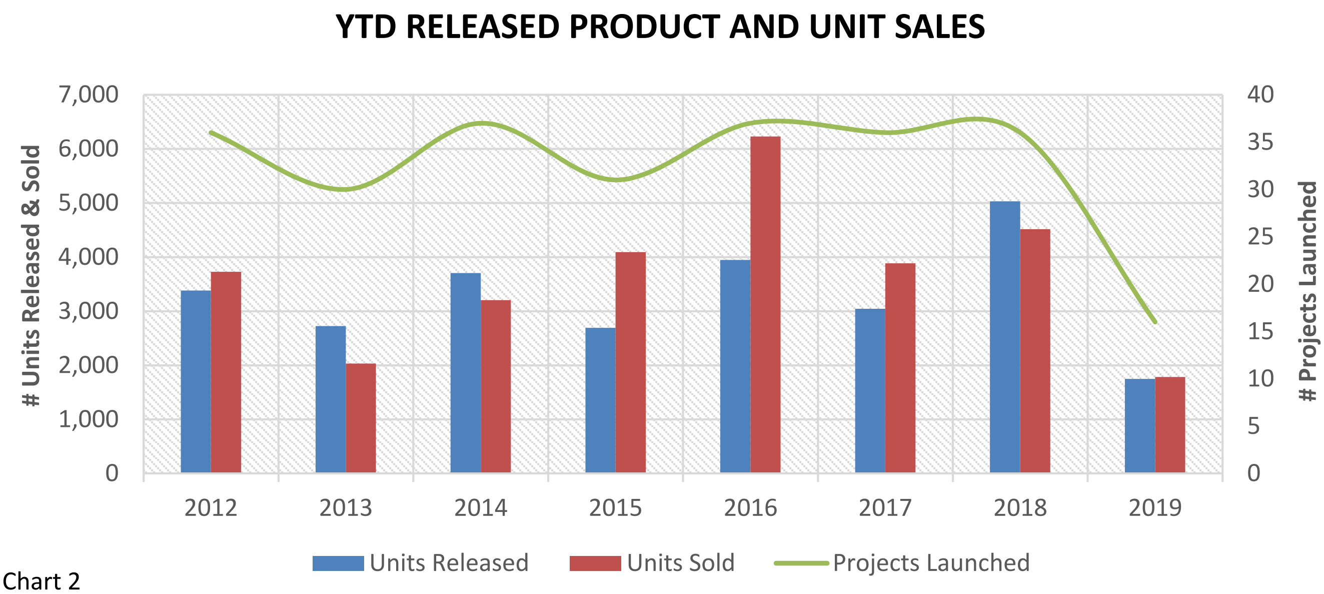

Chart 2

There were 75 percent fewer units released and just over one-third the number of projects launched in Q1-2019 compared to the previous quarter. The year-over-year difference in projects launched and units released is also considerable as half as many new multi-family home projects commenced selling and 58 percent fewer units were released in the first quarter of 2019 compared to the same quarter in 2018. This is not to suggest the market would've absorbed the same number of units had the same number of projects and units been released. However, it can be assumed sales would be higher had more projects been launched.

The same trend was evident when comparing total annual sales in 2018 to previous years. Not surprising given the shifting market conditions of the second half of the year, total annual new multi-family home sales were 13 percent lower than in 2017 and nearly 25 percent lower than in 2016, the strongest year for new condominium and townhome absorptions in recent years. The lower sale volumes were felt across the market with the urban sub-markets experiencing a 13 percent drop compared to 2017 and the South of Fraser sub-markets recording 12 percent fewer sales.

Given investor buyers are largely on the sidelines waiting to see what transpires with the market, it's little surprise the concrete condominium sector of the market experienced the biggest drop in sales during the first quarter of 2019 compared to Q1-2018. Year over year high rise condominium sales dropped by 61 percent compared to the 28 percent drop in the wood frame condominium sector, which tends to attract a greater proportion of end user buyers. The townhome sector also experienced a significant drop in year-over-year sales; just over 700 fewer townhome sales in Q1-2019 compared the first quarter of 2018. Again, this is not surprising given the 84 percent drop in the number of townhome units released this past quarter compared to Q1-2018.

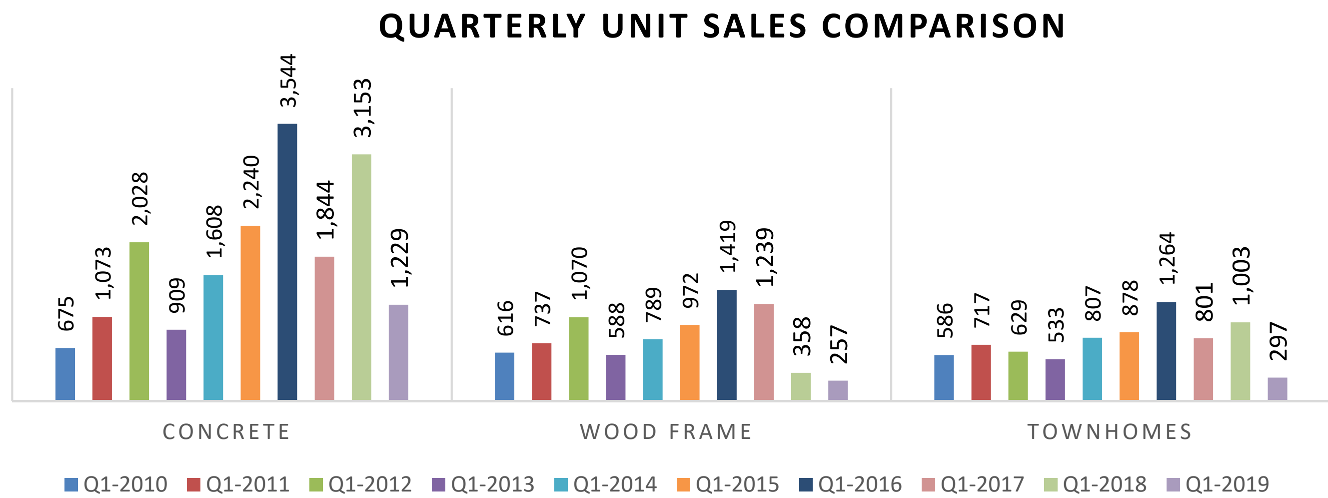

Chart 3

The spread between the number of units sold in a quarter and the number of unsold units in that quarter continued to widen in the first three months of the year and is now greater than in any quarter since Q4-2013. There were more than 6,000 units of unsold inventory in the market at the end of the first quarter than there were units sold during quarter. The widening in this spread will continue to limit urgency levels among buyers as the increased choice of projects and product to choose from will result in a longer buying cycle. It was less than a year ago (Q2-2018) that the number of unit sales in a quarter exceeded the number of unsold units in that same quarter.

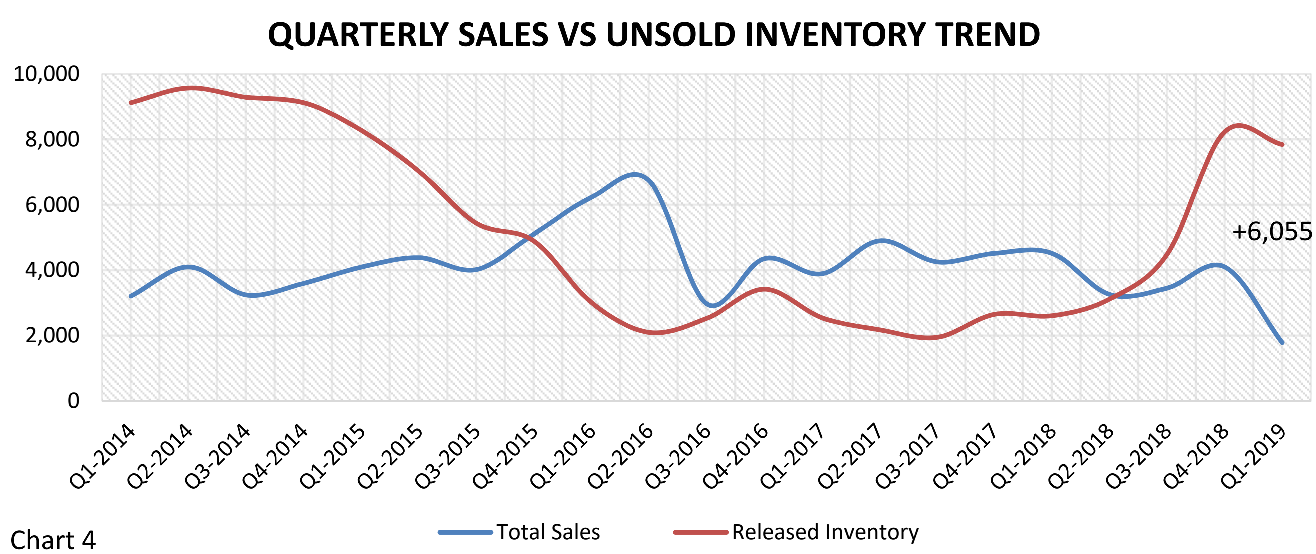

Chart 4

Chart 5 illustrates the number of sales and new supply in each of Metro Vancouver's sub-markets during Q1-2019. There were 1,748 new multi-family units released to the market during the first quarter of the year; 58 percent fewer than in the previous quarter. Interestingly, there were 35 fewer units released than units sold. Thus, despite the large drop in the number of units sold during the quarter, the more limited number of project launches and units released kept the amount of unsold inventory from growing more substantially.

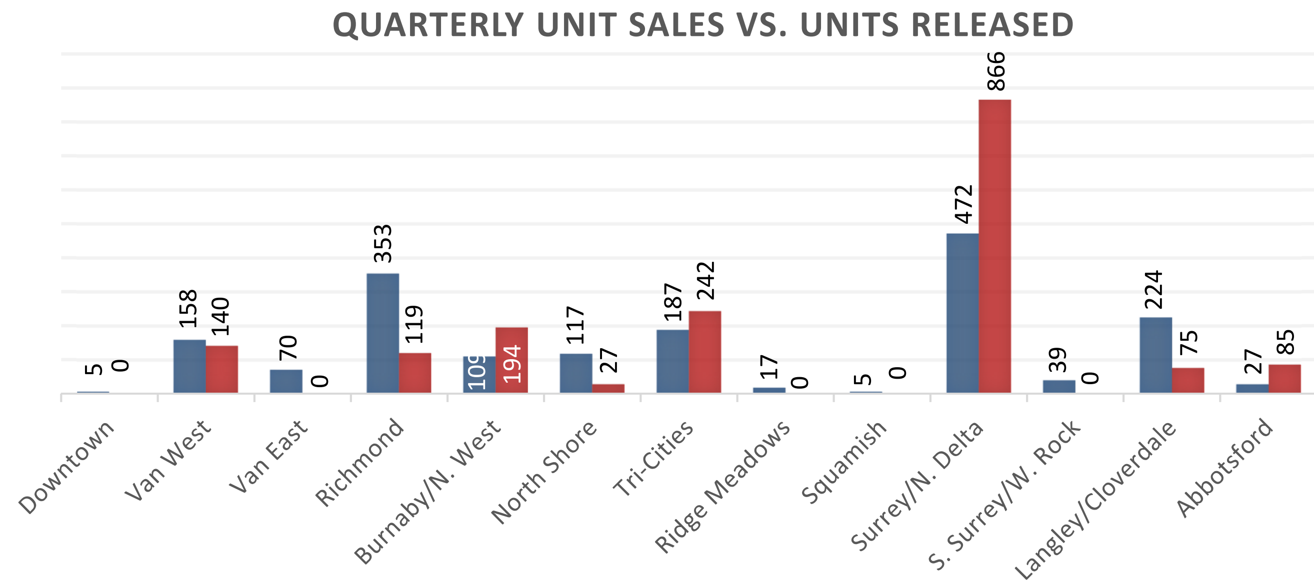

Chart 5

As suggested in the <u>*Q4-2018 UA Take*</u>, '*Successive quarters of similar amounts of new supply being released to the market will likely cause some developers to reconsider the timing of planned new project launches.'* Developers did in fact reconsider the timing of new project launches due to lower buyer urgency levels, with the release of several projects being postponed. The result was a five percent drop in the total number of unsold units at the end of Q1-2019 compared to the end of 2019. Meanwhile, it's not surprising to note the significant year-over-year increase in unsold inventory given the vast difference in the state of the market at the start of 2019 compared to first quarter of 2018.

The more competitive nature of the market is reflected in the number and value of incentives being offered at various new home projects. The more competitive market conditions are expected for the foreseeable future, which will force developers to continue offering higher valued incentives, thereby providing opportunistic buyers with better value than they've realized for several years. Development firms that ignore the change in market conditions and launch projects at list prices based on proforma targets instead of on market expectations should not be surprised when sales fail to meet expectations.

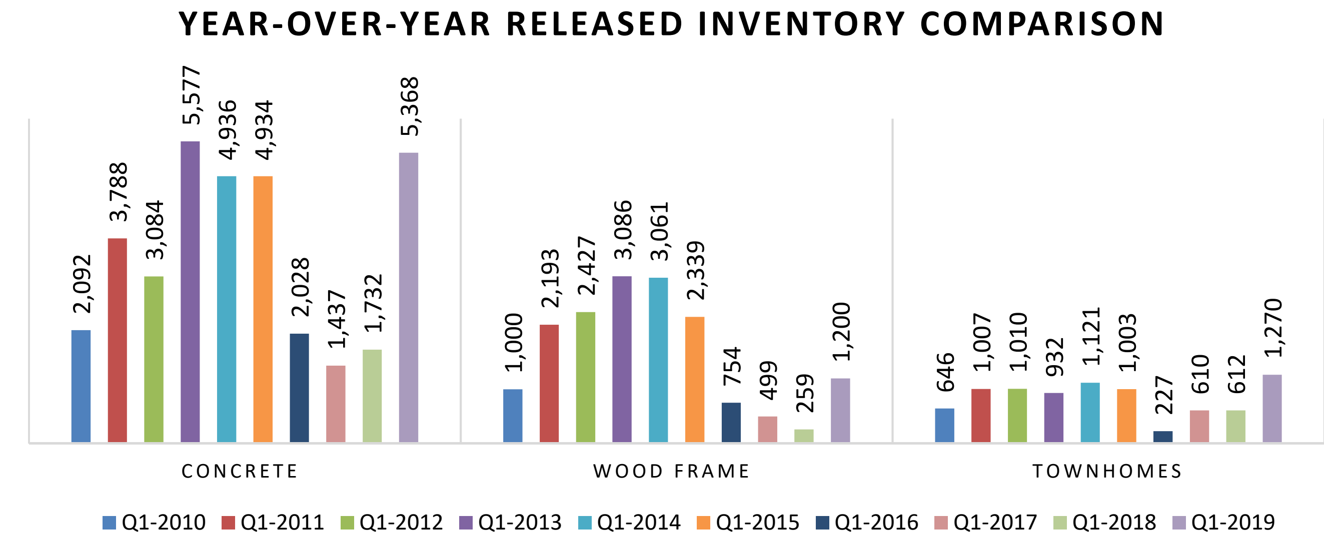

Chart 6

After a quarter during which the number of released and unsold new multi-family units exceeded the number of units sold in nearly all sub-markets, the fewer number of released units throughout the market resulted in much greater balance among the various sub-markets. While sales activity remained very limited in the Vancouver West sub-market, the lack of any significant new project launches in this sub-market resulted in a 77 percent drop in the number of unsold units. The launch of new wood frame condominium product in Tri-Cities and the launch of three new concrete condominium projects in Surrey City Centre led to a 21 percent and 28 percent rise in unsold inventory in those two sub-markets respectively.

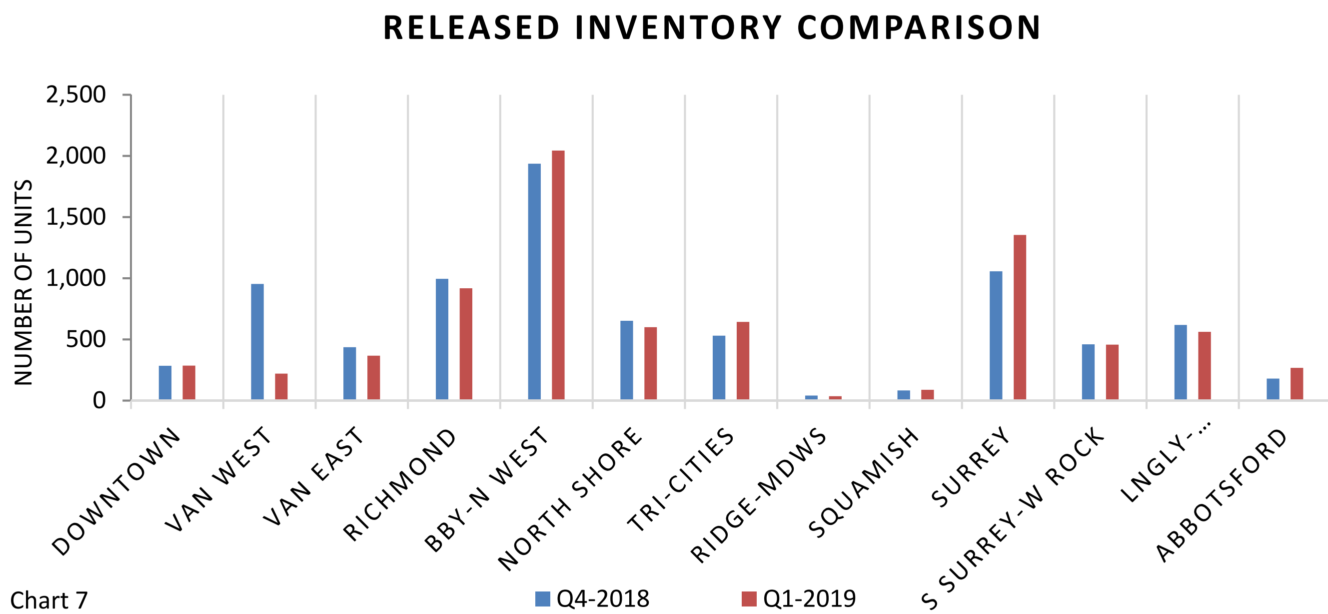

Chart 7

Despite the lower sales volume experienced during the first quarter, and the increase in unsold inventory over the past two quarters, the total number of completed and unsold (i.e. move-in ready) condominium and townhome units has risen moderately over the past few quarters. The 453 units of standing inventory recorded at the end of Q1-2019 represents an 18 percent increase over the previous quarter. It is also well below the high of just over 2,200 completed and unsold units recorded in the last quarter of 2013.

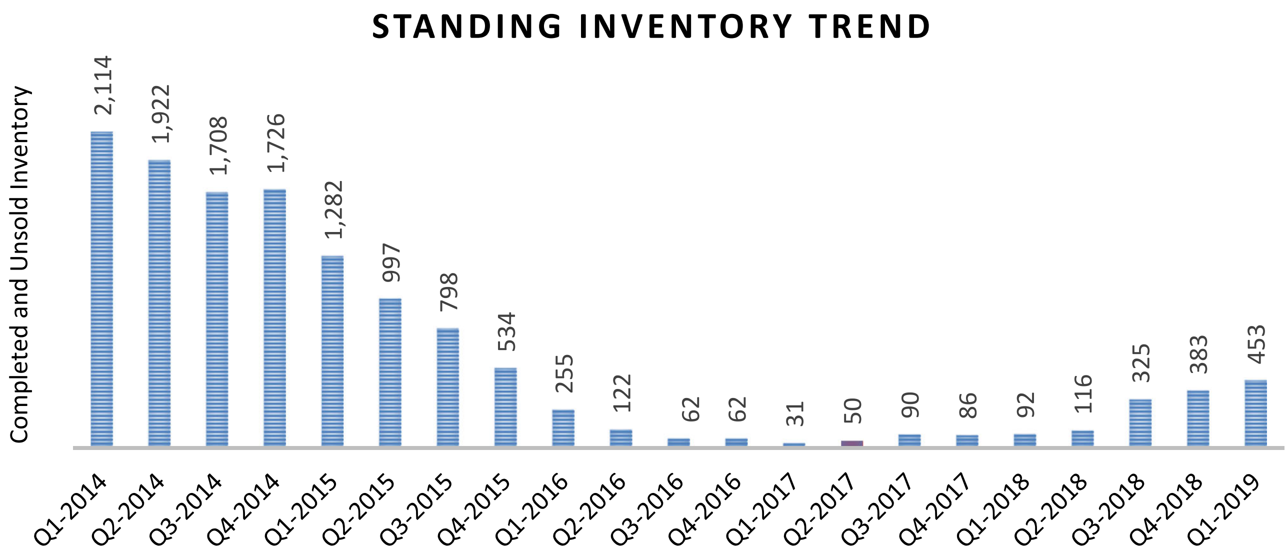

Chart 8

The number of completed move-in ready units remain at manageable levels in all Metro Vancouver sub-markets, with just three areas recording more than 50 units. There is little concern with the higher amount of standing inventory in the South of Fraser sub-markets due to the fact most projects in these areas tend to attract end-user buyers; the most active buyers in today's market.

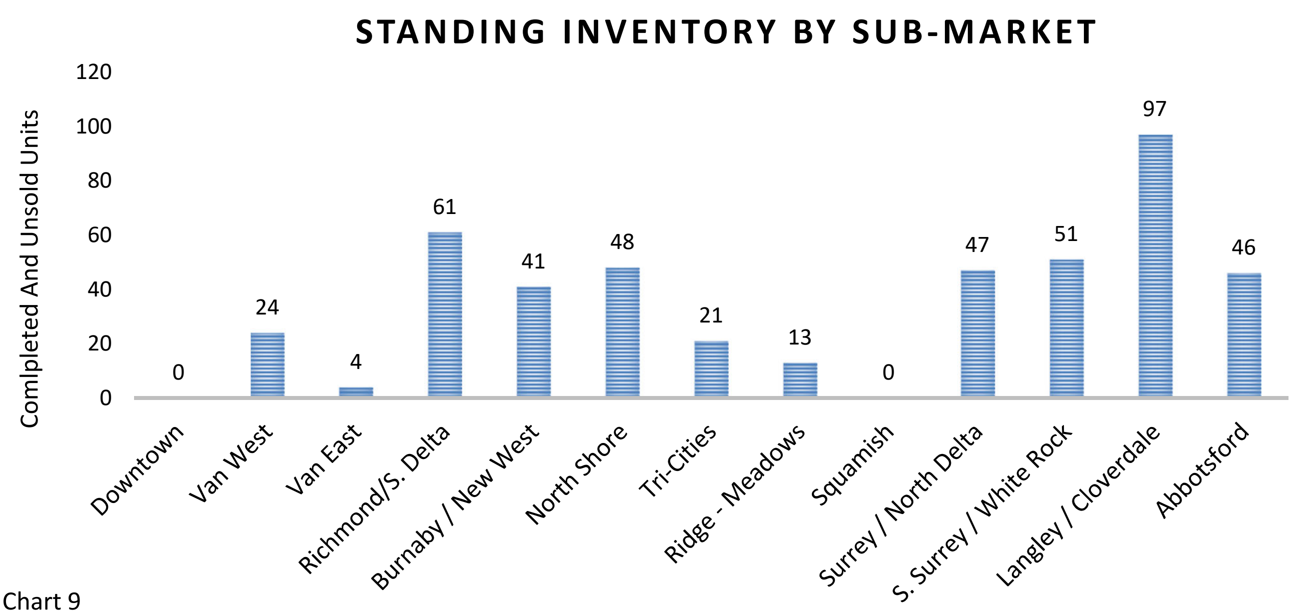

Chart 9

Chart 10 illustrates the construction status of the unsold inventory by product type throughout Metro Vancouver. Again, while total unsold inventory levels have increased in recent quarters, the overwhelming majority of this unsold product is in the pre-construction stage. The nearly 6,100 unsold concrete condominium units may give some cause for alarm. However, given that construction has yet to commence on just under 5,000 of these units and are three to four years from being completed, there is little concern of an oversupply of this product form. The same can be said for the wood frame condominium sector where 69 percent of the unsold units are not yet under construction. The fact 62 percent of the unsold townhome inventory is under construction does not pose any concern as this product is typically not presold, particularly during more moderate market conditions such as those currently being experienced.

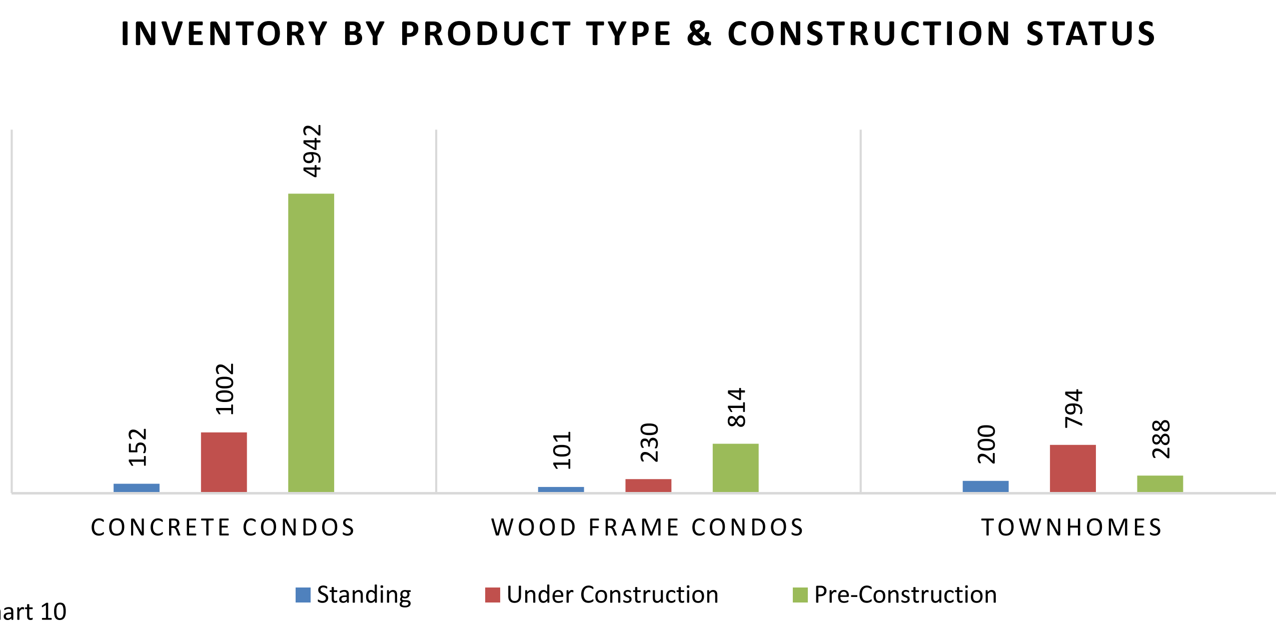

Chart 10

As further support for the suggestion there should be little concern over the recent growth in the number of unsold concrete condominium units, Chart 11 illustrates the number of unsold units in all concrete condominium projects completing from Q2-2019 to the third quarter of 2022. Over 80 percent of all units scheduled to complete over the next three years are already sold. Further, 93 percent of all concrete condominium units scheduled to complete by the end of 2020 are sold.

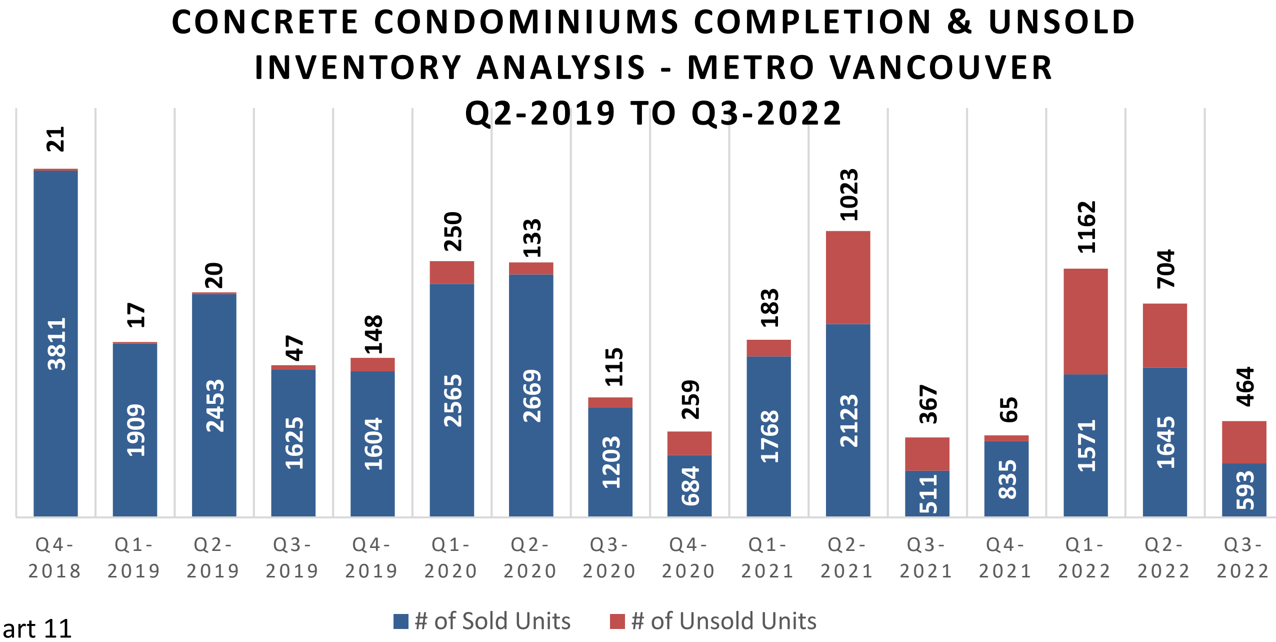

Chart 11

Price Trends

With a few exceptions, developers launching projects in the Metro Vancouver market during the first quarter of the year positioned those projects to reflect the softer market conditions. That is, most developers were careful to price product below what they would have achieved even six months earlier. Developers with projects launched in the first three-quarters of 2018 were required to adjust pricing and/or offer price-reducing incentives for buyers, and attractive commissions and bonuses to realtors to attract buyers. Developers with projects within nine months of disclosure statement filing, but not yet at the number of unit sales required to meet pre-sale requirements set by construction lenders were the most aggressive with pricing and incentives.

Time to rethink REDMA?

Given the much softer market conditions and the prevailing lack of buyer urgency levels in the market, it is becoming much more challenging for developers to meet their 'presale tests' within the nine months prescribed in the Real Estate Development Marketing Act (REDMA). Developers can reduce prices only so far before a project is no longer viable. As such, some projects will likely be cancelled after marketing for several months when presale tests are not met and developers are not willing or able to contribute more equity into a project to obtain financing. This will ultimately lead to more limited supply should market conditions suddenly improve and the majority of remaining inventory is absorbed. UA suggests the Superintendent of Real Estate should consider an amendment to this REDMA requirement and extend the nine month period to 12 or 15 months. This additional time to meet presale tests and obtain financing would also alleviate pressure on developers to achieve the required sales in such a short period of time, which typically encourages them to aggressively court the so-called 'whale' realtors and their investor clients, thereby allowing greater access to these projects for end user buyers..

New vs. Resale Pricing

During periods of higher volume sales in both the new and resale sectors of the multi-family residential market, the spread between average resale prices and the prices sought for new product is generally quite narrow. However, when market conditions soften as they have in recent quarters, this spread tends to grow as the resale market can react much more quickly to lower demand levels than the new home market. Given the current softer market conditions, the spread between resale and new home prices has begun to increase as illustrated in Chart 12 below.

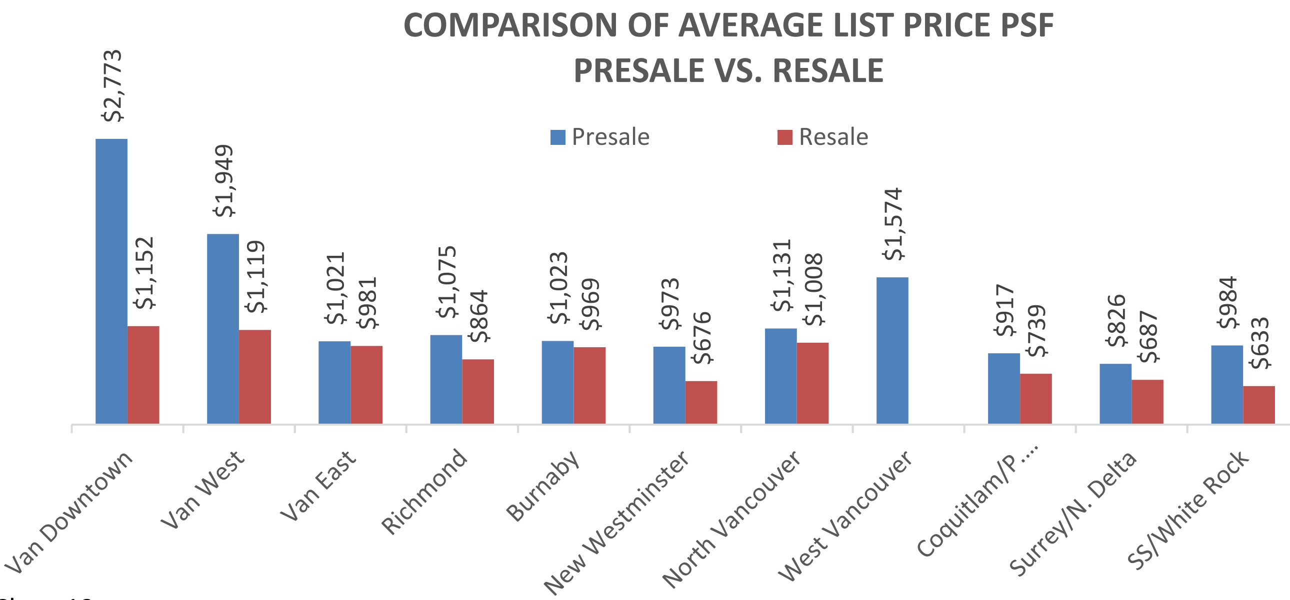

Chart 12

Some of the higher new home values reflect the pricing of projects launched prior to when market conditions began to shift, and therefore does not reflect prices new home projects would be launched at today.

Nevertheless, this metric is worth monitoring over the coming quarters as a widening spread could have a growing impact on market expectations for new home pricing. This will be particularly important over the next three quarters given that some 5,900 new concrete condominium units are scheduled to complete before the end of 2019. Many of these units would have been purchased during pre-construction marketing campaigns in the latter months of 2015 and early 2016 prior to more dramatic price increases for this product form. The lower prices paid for this product would allow buyers seeking to assign prior to completion or sell shortly thereafter to allow lower prices than might be sought by new product today and still realize a profit.

The following provides a summary of average sale values UA estimates are being attained in the more active Metro Vancouver sub-markets and neighbourhoods. The noted values are exclusive of buyer and realtor incentives:

- *Vancouver Downtown* – The next concrete condominium project scheduled to launch in Q2-2019 is expected to seek average sale values of approximately $1,900 per square foot.
- *Vancouver West* – New concrete condominium product slated to commence marketing in the coming months along the Cambie Corridor should expect to seek sale values of approximately $1,300 per square foot. Luxury wood frame condominium projects are expected to seek average values of under $1,200 per square foot. Less luxurious product should expect to achieve closer to $1,150 per square foot.
- *Richmond* – Concrete condominium projects seeking average *net* sales values under $1,000 per square foot are achieving the highest absorptions.
- *Burnaby* – Concrete condominium projects in the Brentwood neighbourhood seeking average net sale values under $1,000 per square foot are experiencing reasonable absorption levels. Buyers are resisting concrete condominium product priced above $1,100 per square foot in Metrotown. Developers planning to launch concrete condominium product in the Lougheed area should seek average sale values under $900 per square foot to experience reasonable absorptions.
- *New Westminster* – Concrete Condominium projects in New Westminster have adjusted pricing to reflect the shifting market conditions and are now seeking average net sale values under $850 per square foot.
- *North Shore* – Softer market conditions have forced actively selling concrete condominium projects to reduce pricing by approximately 5 to 10 percent. Developers launching product here should seek average sale values of $900 to $1,100 (depending on location) to achieve reasonable absorptions. Wood frame condominium values have also dropped with buyers more resistant to average pricing over $850 per square foot.
- *Tri-Cities* – Developers contemplating concrete condominium product in this area should expect to seek average sale values between $800 and $850 per square foot to achieve desired absorption levels. Recently launched wood frame condominium product located along the Clarke Road corridor is achieving modest absorptions at average net sale values of $730 to $750 per square foot. Townhome developers continue to adjust prices accordingly to create and sustain sales activity.
- *Fraser Valley* – While concrete condominium product in Surrey City Centre launched in Q1-2019 sought average sale values ranging from $780 to $830 per square foot. Reported absorptions have been steady at these prices. Limited buyer urgency levels continue to make absorptions a challenge for concrete condominium projects in South Surrey/White Rock.
    - Recently launched wood frame condominium projects in Langley/Cloverdale continue to seek average sale values of $525 to $550 per square foot.
    - The most active recently launched townhome projects in Fraser Valley sub-markets are seeking the following average values:
        - *Surrey/North Delta* – $370 to $420 per square foot

    - *South Surrey/White Rock* – $380 to 420 per square foot
    - *Langley/Cloverdale* – $410 to $440 per square foot
- Abbotsford – Wood frame condominium projects seeking average sale values between $475 to $510 per square foot have experienced strong demand. Successful townhome projects are achieving average sale values of $350 to $380 per square foot.

Buyer Trends

A lack of urgency among all buyer groups is the most notable trend among prospective purchasers of new multi-family home product in Metro Vancouver during recent quarters. While end user buyers remain active as they seek to take advantage of the increased product choice, lower pricing and higher valued incentive offerings, they are still taking considerably more time to make their buying decision as they consider their options. For end user buyers who have a home to sell to facilitate the purchase of a new home, concerns about lingering softness in the resale market are also giving them pause. For younger end user buyers, indications we're unlikely to see any interest rate hikes in 2019 is a relief, but they're still facing challenges getting qualified for a mortgage due to the B20 Stress Test. There is hope the federal election in the fall could bring some relief for these buyers.

Meanwhile, both pure cash flow investors and speculators remain largely on the sidelines as they wait for signs of the market bottoming out. Investors who remain active are being very selective with what and where they buy and are not shy about grinding for a bargain. Speculative investors are likely out of the market for the foreseeable future given current pricing trends. However, longer-term hold investors are more likely to re-enter the market sooner as the combination of rising rents and lower purchase prices shrinks the gap between rents and debt servicing costs and make an investment for rental purposes more viable.

Given these prevailing buyer sentiments, projects targeting end user buyers will continue to experience steady albeit modest absorptions in the second and third quarters of the year. Projects more inclined towards investor buyers will need to demonstrate exceptional value and/or differentiation in the marketplace to induce this buyer group off the fence. Developers and marketers of product that typically appeals to investor purchasers are in for a challenging period.

Looking Ahead

The softening market conditions and reduced revenues projects can expect to achieve in today's market has caused many developers to postpone launching new projects, particularly in the concrete condominium sector. The launch timing of projects that were expected to launch in the past two quarters is now uncertain as developers continue to monitor and evaluate market conditions and achievable revenues. As such, UA will not provide a list of projects it expects to launch in the next two quarters in this UA Take. This section will return when there is more certainty around the project launch timing.

Of course, UA will continue to monitor the sales progress of all new multi-family projects that are launched along with those already actively selling and updating the data as it is collected on *NHSLive.ca*.

UA maintains the most current database of actively selling and contemplated new multi-family home projects in Metro Vancouver, Calgary and Edmonton on NHSLive.ca. UA analysts are constantly updating the data for the most active projects to ensure our subscribers are as current as possible. In addition to the *Multi-Family Home* platform on *NHSLive.ca*, UA also offers subscription access to new purpose-built rental data and land transaction data on NHSLive. Please call for a demonstration of both these products and to inquire about our advisory services to help you appropriately design and position your next project.

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