

# Housing slump stalks Western Canada

Major cities in Saskatchewan, Alberta and B.C. are overvalued by 10 per cent, economists say as key construction indicator tumbles

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As Canada's housing market shows fresh signs it has exited the boom phase, Merrill Lynch economists are cautioning homeowners to expect a "sustained downturn" in prices.

Nearly every major city in the West makes the list of most vulnerable markets, in addition to Montreal and Sudbury, according to a pair of Toronto-based economists at the bank.

Soaring prices over much of the past decade have made the country's homeowners substantially richer. The big question is whether a selloff could echo the wrenching downturn in the United States, where prices in Miami and Los Angeles have fallen as much as 28 per cent from the peak and average national prices are down 18 per cent in the past two years.

The Merrill Lynch Canada study, which predicts a retrenchment, but not of the same magnitude as in the U.S., concludes the country's housing market is now the most expensive since 1991.

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Markets in Regina, Saskatoon, Vancouver, Victoria, Calgary, Edmonton, Sudbury and Montreal are all more than 10 per cent overvalued, as calculated by economists David Wolf and Carolyn Kwan.

Their analysis, which calculates fair value by using variables such as current prices, affordability and long-term average valuations, landed on the same day Statistics Canada said both residential and commercial construction intentions tumbled in June.

In sifting through recent data, the Merrill economists believe the country's housing market will suffer from excess supply and reduced demand as higher prices deter new buyers. They expect house price appreciation will stall, with western markets "most vulnerable to outright declines."

Other markets exposed to downward pressure include urban condos and suburbs where commuters face higher transportation costs due to rising fuel prices.

This retrenchment won't be nearly as severe as in the U.S. though, Mr. Wolf emphasized.

“Are prices going to fall 20 per cent the way they did in the U.S.? Probably not,” he said. “But it's pretty clear that things are weakening and they're going to continue weakening for some time.”

Credit is the main difference between the two countries. Looser credit conditions south of the border fuelled easy lending, which in turn created excessive demand.

“We never had that kind of credit excess in Canada,” Mr. Wolf said. Plus, much of this country's boom has been making up for lacklustre activity throughout the 1990s.

Now, after years of ever-pricier homes and aggressive building, scales may have tipped.

The Merrill economists are most concerned about Saskatchewan, where the doubling of house prices in Regina and Saskatoon over the past two years means, they estimate, these markets are almost 50 per cent overvalued.

In B.C., Vancouver's and Victoria's housing markets are now as much as 35 per cent overvalued, they believe. Markets in Alberta, meantime, have become slightly less overvalued in the past year.

The rest of the country looks “better balanced,” they said, with housing in Toronto essentially at fair value.

Slowing activity and moderating prices would have broad economic ripples. Mr. Wolf sees cooling residential investment dampening inflation and knocking 0.6 percentage points off real gross domestic product next year.

Builders are already more cautious, with Statscan's report Thursday showing building permits fell 5.3 per cent in June – the steepest drop this year. Last week, a Canadian Real Estate Association report showed sales activity slumped 13.1 per cent in the first half of the year. National house prices, though, have so far held steady.

The head of construction powerhouse EllisDon is “very concerned” about where the Canadian economy is heading, and what it might mean for building activity.

“I am worried right across the country that things are tightening up and that a year from now we are going to see a drop-off,” said Geoff Smith, the company's president and CEO.

Nowhere has the market been more wild in the past year than Saskatoon, which has bubbled with stories of bidding wars and frenzied speculators.

Yet soaring house prices may finally be deterring buyers.

“It's quiet on the buyers' side. Listings are up, sales are down,” said Ken Glauser, associate broker at Henry Moulin Realty Inc. “Surprisingly, the overall average price isn't down though.”

He expects a slight cooling-off in prices, but says a strong local economy means they won't fall much. And he's rather relieved the market is losing some of its fevered pitch.

Nowadays, "people can go home and think about their bids overnight," Mr. Glauser said. "Last year, they could hardly get back to their car to think about it."

*With a report from Virginia Galt*

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