

# Canadian Real Estate Bubble Deflating

In just one year, the housing market has undergone a complete turnaround in certain regions of the country. The decline in real estate prices, which began in Western Canada in the summer of 2008, is now affecting half the main cities nationwide.

Since the summer of 2007, the problems distressing the U.S. real estate market have continued to make headlines. Since its peak in January 2006, housing starts have plummeted about 75% and average prices for existing properties have fallen nearly 25%. Regional price drops differ greatly, from 6% in Dallas to 43% in Phoenix, and should continue until it reaches 35% overall across the U.S. There are many factors behind the crash. It is important to recall, however, that the bubble that started in the early 2000s was amplified by the increase in high-risk loans, i.e. financing granted to borrowers with a low credit rating. The scope of the financial crisis has thrown the United States into a severe recession. Access to credit remains tight and the residential sector has not yet hit the bottom of the barrel. Although the worst seems to have passed, there has as yet been no perceptible sign of stabilization.

## PRICES FALLING IN CANADA

Although lenders were much more cautious on this side of the border, the economic deterioration had the effect of a cold shower on the real estate market. Prices have gone down by around 15% since the peak at the end of 2007—a correction similar to the 25% drop that has been seen up to now in the United States.

The Canadian housing market showed exceptional vitality up until the summer of 2008, but since that time has seen a sudden change of direction. The impact of the world financial crisis, which led a number of industrialized countries, including the United States, into recession, has considerably dampened the economic outlook for Canada. October's severe stock market correction, which plunged consumer confidence to a nearly all-time low, together with increased unemployment and the drop in the price of raw materials have shaken Canada's economy as well.

The real estate market was caught up in this wave and has been severely affected. New construction is down. Home sales have plummeted and prices have undergone a major correction in several markets across Canada. Although interest rates have been lowered, stricter rules on mortgage insurance have tempered demand for housing. The minimum 5% down payment, the obligation to



pay down principal and interest as of the first year and the reduction of the maximum amortization period from 40 to 35 years have restricted access to home ownership since October 2008.

The price drop began in the cities of Western Canada, where the market has been intensely overheating in recent years. Since properties there are relatively expensive, the deterioration of economic conditions quickly had a negative impact on demand. In just one year, the number of sales plummeted by 38% in Alberta and 49% in British Columbia.

Prices followed with respective slides of 7.4% and 6.0% at the end of 2008. The trend eventually reached Ontario, where several towns are now suffering from the throes of the automobile sector. Toronto was not

“Canadian real estate market severely affected”

spared: there were 45% fewer transactions in December, while prices fell by 8.5%. The year ended on a sour note for those markets, and it would seem that this trend will continue to worsen in 2009.

### PRICES STABILIZING IN QUÉBEC

Until just recently, the rise in new housing constructions was not fast enough to meet demand for home ownership, which led to scarcity on the resale market. This strong sellers' market created a spike in prices, even exceeding 10% per year in the first half of the decade. Since the beginning of the upward cycle in 1997, prices have more than doubled. In 2008, properties in Québec cost an average of \$210,775, which re-



presented growth of 3.9%. The average price of a single-family home reached \$265,683 in Greater Montréal and around \$375,000 on the Island itself. Québec City and Gatineau both broke the \$200,000 threshold, while Sherbrooke was closing in at \$193,300. Prices went up throughout the province last year, but 2009 will be quite different.

Signs of less intense activity have been increasing in the last few months in Québec. Sales of existing homes fell by nearly 20% at the end of 2008, while prices have stabilized. Since the resale market is now balanced, further economic deterioration could create a surplus situation, which may lead to lower prices, as was the case in the early 1990s. The financial crisis and North American recession will not spare Québec's economy, which is expected to weaken until at least summertime. Aside from the low level of consumer confidence, the job market in the province is now also being affected. Job losses have led to a gradual rise in unemployment, which is now above 8%.

### END OF THE BULL MARKET CYCLE

This year, the real estate market in Québec will experience a further slowdown, although not to the same extent as what is happening in the United States or certain regions in Canada. Housing starts and home sales will likely fall back by around 10%, and slight price reductions are likely to occur due to the current climate of uncertainty. The worst-case scenario could see a 5% drop occur in 2009, but this correction will not be sufficient to completely erase the gains made in recent years. Nonetheless, anyone who purchased at the end of the bull cycle will be the biggest losers should there be any further decreases in prices. **D**



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