Economic Viewpoint

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# Quebec's condo market is still in surplus

## New construction and prices will keep adjusting

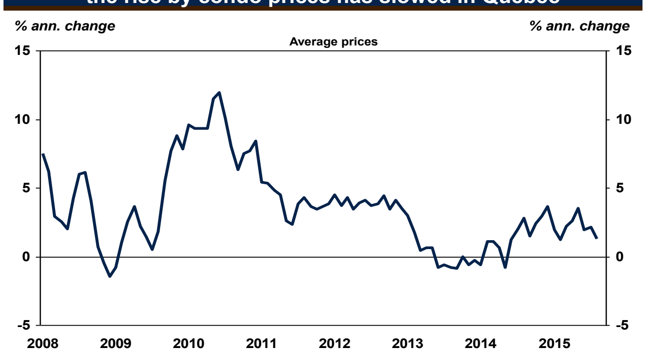
The condo market boom has given way to a tougher context. Buyers are scarcer, while supply is still growing. The outcome: both the new and resale markets are in surplus. Already, in a number of agglomerations, prices are flat or dropping. An adjustment phase has begun, but it will take more than a year or two before sounder conditions return. To get there, new construction will have to be quite limited, especially as the rental market is becoming more popular.

### RESALE MARKET: PRICES ARE CHOPPY

Three years ago, the wind changed for Quebec's condo market. The prevailing equilibrium has given way to surpluses for a number of reasons. For one thing, the drop in buyer demand, especially from young households, kicked off a change in the trend. The introduction of tighter mortgage regulations in July 2012, which lowered the maximum amortization period from 30 to 25 years for loans with down payments under 5%, began to sap demand for condos. After that, the increase in the number of condos for sale in the new and resale markets put an end to the boom.

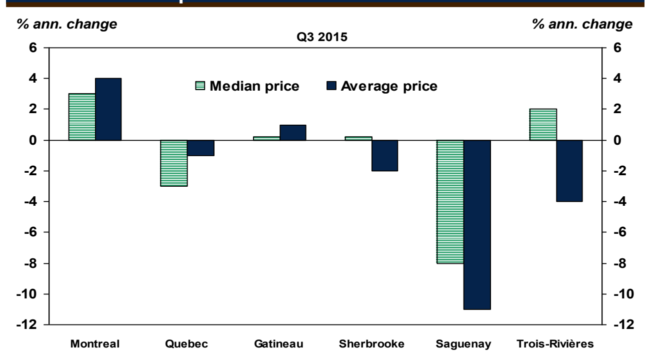
Times to sales have increased to four months, in average, and the rise of prices quickly ran out of steam (graph 1). The time of price increases of 5% to 10% a year has given way to stagnation or price decreases in some locations. Slight declines have begun in Quebec and Sherbrooke, but prices are down more steeply in Trois-Rivières and Saguenay (graph 2). Montreal and Gatineau are still seeing small increases.

Graph 1 – Condo resale market: the rise by condo prices has slowed in Quebec




Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

Graph 2 – Condo resale market: prices down in several CMAs




Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

### APPEAL HAS WANED FOR SEVERAL REASONS

The change in heading has changed potential buyers' perceptions. Buying a condo is no longer as appropriate for those who plan to resell within a few years. Longer times to sale, the lower likelihood of price increases, and even a chance of selling for a little less than the purchase price weigh in the balance. However, long-standing buyers who benefited from the rapid rise in values of the past are still realizing capital gains when they sell their condos, even though prices may have come down a little lately.

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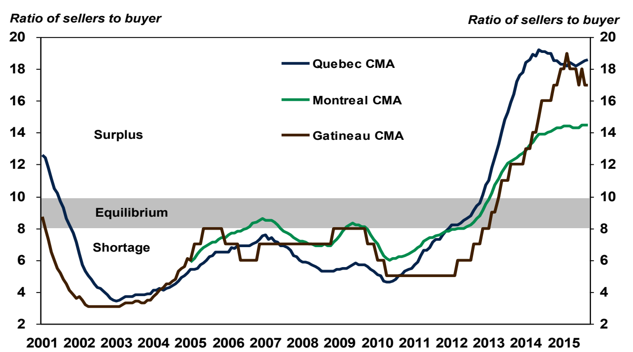
Moreover, condo require a contribution to contingency funds to cover necessary work, and management in this area is sometimes inadequate. According to a recent survey,[1] 41% of condo buildings have a shortfall when the time comes to carry out major work. In 61% of cases, a single special contribution of up to several thousand dollars is quickly required. Managing the finances of condo apartments can involve some surprises, steering some potential buyers into the rental market.

According to the calculations done by Les Affaires Plus[2], it is now more advantageous financially, in most cases, to opt to rent an apartment than buy a condo. Municipal and school taxes, as well as common costs, increase expenses. Even assuming slight price growth, the value gained over 10 years is not enough to favour a condo purchase.

## WIDESPREAD SITUATION

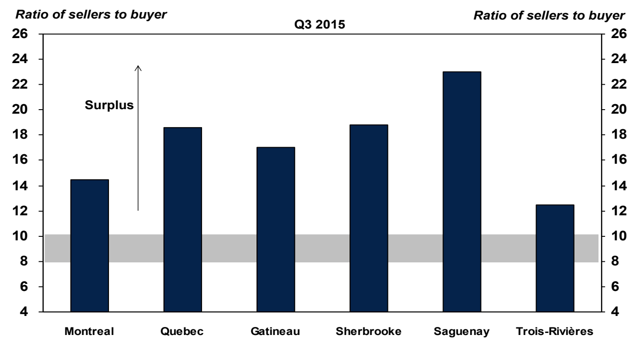
For the last year, the number of condos on the market has substantially exceeded demand in the resale market, particularly in Quebec, Montreal and Gatineau (graph 3). In fact, all of the province's metropolitan areas have surpluses, with the buyer to seller ratio above the threshold for equilibrium (graph 4). The market is in surplus in all price ranges in Montreal and Quebec (graphs 5 and 6) and in most sectors (tables 1 and 2 on page 3). Some observations: the condo surplus is much bigger for higher-end condos, while the resale market is a lot healthier for units priced below $300,000. That is the case in Montreal, Quebec and Gatineau, the only agglomerations for which statistics by price range are available.

**Graph 3 – Condo resale market: substantial surplus for the last several years**



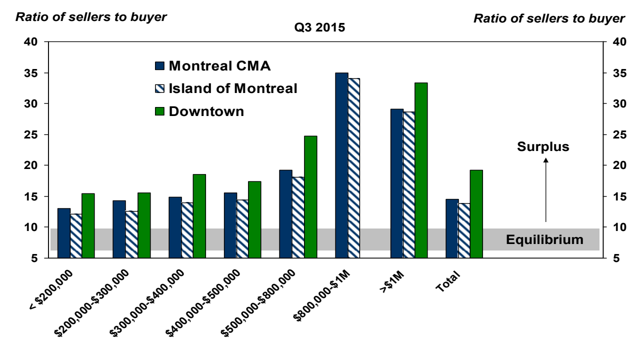

Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

**Graph 4 – Condo resale market: in surplus in six Quebec CMAs**



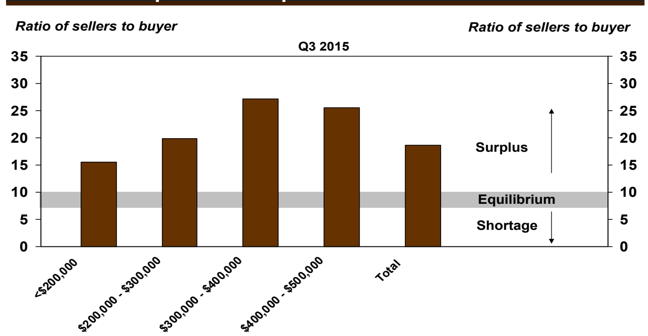

Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

**Graph 5 – Condo resale market: more out of balance in downtown Montreal**




Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

**Graph 6 – Condo resale market: all prices in surplus in the Quebec CMA**




Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

[1] Regroupement des gestionnaires et copropriétaires du Québec, Québec Federation of Real Estate Boards and Association provinciale des constructeurs d'habitation du Québec "Sondage portant sur les fonds de prévoyance des copropriétés au Québec, October 2015."

[2] Simon Diotte, "Louer ou acheter : quel est le meilleur investissement?" *Les Affaires Plus*, November 2015.

**Table 1 – Condo resale market: two more problematic zones in the Montreal CMA**

| Sectors | Ratio of buyers to seller (Q3 2015) |
|---|---|
| Island of Montreal | 14 |
| Île-des-Soeurs | 20 |
| Ville-Marie (downtown) | 19 |
| Laval | 16 |
| Montreal's North Shore | 17 |
| Montreal's South Shore | 15 |
| Vaudreuil-Soulanges | 15 |

Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

**Table 2 – Condo resale market: very big surplus in some sectors of the Quebec CMA**

| Sectors | Ratio of buyers to seller (Q3 2015) |
|---|---|
| Basse-Ville | 20 |
| Haute-Ville | 21 |
| Les Rivières | 14 |
| Sainte-Foy, Sillery | 16 |
| Cap-Rouge, St-Augustin | 16 |
| Val-Bélair | 24 |
| Charlesbourg | 18 |
| Beauport | 19 |
| Haute-Saint-Charles | 30 |
| Quebec City northern edge | 22 |
| Lévis | 18 |

Sources: Quebec Federation of Real Estate Boards, via Centris® and Desjardins, Economic Studies

The surplus is fairly widespread in these three census metropolitan areas (CMAs), but some zones have more of a problem, particularly downtown Montreal. Heavy condo construction in recent years, focusing within this area, magnified the imbalance in the resale market. The recent launch of a number of projects takes the number being built to 7,145 on the island of Montreal, with more than 4,000 of them downtown (graph 7). The supply will be even larger when work is completed, increasing the market's imbalance further. Sounder conditions will not be back in downtown Montreal for the foreseeable future.

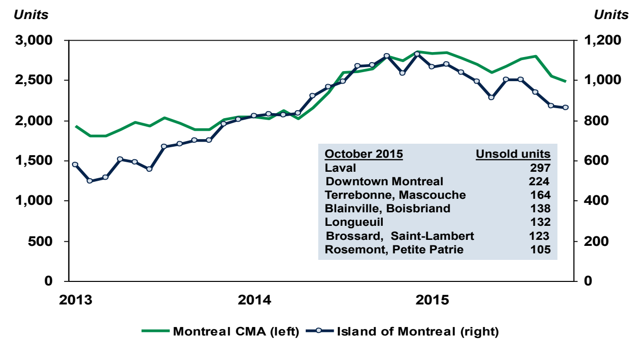
In Quebec CMA, the too-rapid upswing by condo starts in 2015 will also keep market conditions from improving. Only Gatineau is on the right track: there, the buyer to seller ratio fell recently, and construction has dropped sharply; this will make it possible to gradually sell off the surplus.

### NEW CONSTRUCTION IS FINALLY ADJUSTING

In Quebec, the boom in condo starts went on for too long without factoring in the less sustained demand. The appeal of new units which apparently justified the pace quickly waned over time. The number of completed, unsold condos has thus skyrocketed. Developers/builders had to take their feet off the gas to adjust to the new situation.

In 2015, housing starts fell in the province's CMAs, except Québec (table 3). In the capital, however, construction had flagged earlier in 2014 and the recent upswing seems premature. It is therefore not surprising to see that prices have started to come down slightly in Quebec CMA, as the market is not yet ready to absorb another round of building.

**Graph 7 – Number of new, completed, unsold condos in the Montreal CMA**




Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

**Table 3 - Condo starts in Quebec CMAs**

| | *January to November 2014* | *January to November 2015* | *January to November 2015/2014* |
|---|---|---|---|
| | Level | Level | % ann. Change |
| **CMA** | | | |
| Gatineau | 555 | 262 | -52.8 |
| Montreal | 9,580 | 7,215 | -24.7 |
| Quebec | 959 | 988 | 3.0 |
| Saguenay | 28 | 10 | -64.3 |
| Sherbrooke | 83 | 163 | 96.4 |
| Trois-Rivières | 220 | 84 | -61.8 |
| **CMA total** | **11,425** | **8,722** | **-23.7** |

Sources: Canada Mortgage and Housing Corporation and Desjardins, Études économiques

**BOX 1**
**IMPORTANCE OF PRESALES**

In general, when developers or builders ask a financial institution for financing, at least 55% (sometimes up to 65%) of the project's condos must already be covered by a sales contract. That means that, usually, buyers only have to be found for at most 45% of the remaining units, either during or after construction. In general, developers or builders generate their profit margin on the sale of the last units, so condos that are taking time to move can quickly become a financial burden. If they are not sold, the developers and builders may opt to rent them, to bring in monthly revenue that will keep them going. This is often a last resort solution, as the costs of managing and maintaining the building must be borne, eating into the rental income. To ensure that projects make a profit, it is usually better to sell the condos as quickly as possible. Also, some industry players do not need to borrow, as they have substantial cash on hand. They can thus launch a project on just a few presold units, a risky approach for both the contractor and the overall market.

In general, it will take a few years for market conditions to justify another wave of housing starts. There will be fewer new projects and some will be justified, depending on buyers' needs in each large agglomeration sector. Developers/builders will have to be cautious while capitalizing on market potential in some locations. For those who go ahead, it will be a matter of better targeting the clientele for choice locations. Strong presales within a short period of time usually limit the risks at the start for a new project (see box 1).

### WHEN WILL THE SITUATION RETURN TO NORMAL?

In short, the appeal of condos has eroded somewhat for a number of reasons. High prices are now putting many buyers off, especially young households who have a hard time getting a down payment together. Moreover, stagnant and declining prices in some places not only limit the short-term potential for appreciation but also lead to a negative spiral for the market. A gloomier perception will continue to affect buyers until the surplus is absorbed. It will take more than just a year or two to get there. New construction will have to be contained for as long as it takes to clean up the market's foundations. This will allow it to gradually head toward the equilibrium zone, a prerequisite for seeing modest price increases once again. Over the longer term, condo values should rise at a pace similar to inflation's, about 2% a year. The time of big price increases definitely seems to be over.

### SUMMARY: RESALE MARKET

- Persisting imbalance between supply and demand.
- Times to sale are increasing.
- Average prices are stagnant or declining in most CMAs (they are still rising in the Montreal CMA).
- The nearly general hesitation by prices is changing how potential buyers see things. Less potential for short-term appreciation: a major drawback for some buyers.
- If resold after only a few years, there's a risk that the selling price will be slightly lower than the purchase price.

### SUMMARY: NEW CONSTRUCTION

- Housing starts are down in most metropolitan areas.
- Even in a glutted market, some new buildings have a lot of appeal and new units are selling off quickly. A quick commitment by many buyers during the project's presale period is a good indicator of success.
- Some projects have been cancelled or postponed as the percentage of presales was too low to launch the project.
- Some projects are still selling out quickly, while others are struggling. A choice location, innovative concept and precise positioning based on the target clientele can make the difference.
- Projects that need financing from a financial institution are sometimes hurt by competition from developers/builders who have sufficient cash on hand to avoid taking loans. This lowers project execution costs and may lower unit selling prices, too.
- Many developers/builders have had to offer a range of financial incentives to find takers for remaining units, while others cut their initial sale price.
- If unsold, more new condos end up in the rental market. This is not as profitable an option, in general, but it limits the financial losses for developers/builders.

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