

February 18, 2013

Residential real estate at a crossroads

After several years of booming activity, Quebec's housing market has taken a turn that is raising more than one eyebrow. What will be the scope of this slowdown? Should we expect a period of price correction? Will the wave of new condos expected to hit the market in 2013 tilt the market to a surplus situation in Quebec City and Montreal? Is new construction about to nosedive? While a yellow flag may be in sight, the favourable economic situation will prevent a sharp downturn in Quebec's residential sector. The soft landing will continue in 2013 however, as our most recent forecasts attest.

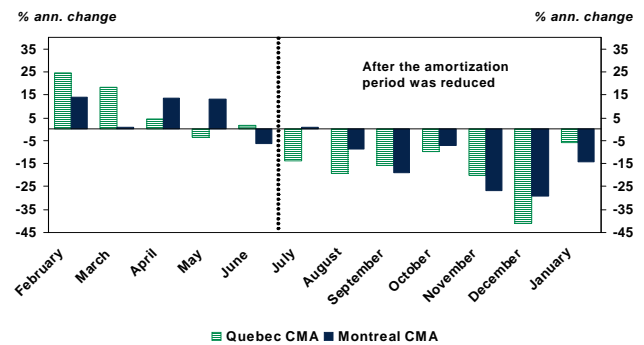
WHAT IS FUELLING THIS SUDDEN CHANGE IN SALES?

In July 2012, the federal government reduced the maximum amortization period from 30 to 25 years for mortgage loans with a down payment of 5% to 20%. This new measure had teeth. The objective—to cool the residential real estate market and rein in rising debt levels—was reached. The resale market in Canada's biggest cities weakened almost immediately last summer, and a downtrend seems to have taken root since then.

The shorter amortization period affected mostly first-time buyers who usually have a smaller down payment and a more limited budget to cover monthly mortgage payments. Many first-time buyers lean towards buying a condo because condominiums are much more affordable than single-family dwellings, which are out of reach for most young households. Even if baby-boomers have a weakness for the more upscale units, condos remain the product of choice for first-time buyers.

As a result, condo sales have fallen more sharply than home sales since the summer of 2012. In December, condo sales in Montreal plummeted 29% for example (graph 1), compared to a drop of 13% for single-family homes. In Quebec City declines of 41% and 32% were posted, respectively. There is still a shortage of single-family dwellings despite this less steady activity, meaning that the pool of available properties is not enough to fully meet demand from potential buyers.

Graph 1 – Existing condo sales have tumbled since mid-2012



Sources: Fédération des chambres immobilières du Québec and Desjardins, Economic Studies

Market conditions for condos have taken a sudden turn since last summer, however (graph 2 on page 2). In Quebec City, the number of buyers to sellers was already beyond the equilibrium threshold, i.e. between 8 and 10. This slight surplus means that buyers have the upper hand when negotiating prices, a first since the early 2000s. If the trend continues, the same situation will soon take place in Montreal. That said, the condo market in Gatineau should remain balanced in 2013.

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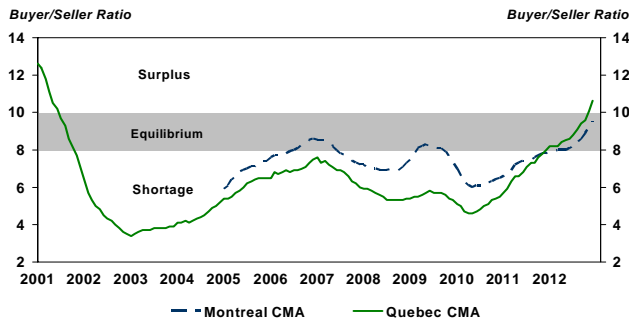
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NOTE TO READERS: The letters **k**, **M** and **B** are used in texts and tables to refer to thousands, millions and billions respectively.

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Graph 2 – The condo market is no longer in equilibrium



Sources: Fédération des Chambres immobilières du Québec and Desjardins, Economic Studies

WILL CONDO PRICES HOLD FIRM?

The last time condo prices were on an extended slide was in the 1990s, at a time when the number of condos for sale largely exceeded buyer demand. At that time, the ratio of buyers to sellers reached almost 50 in Quebec City and exceeded 30 in Montreal—a far cry from the current situation. Getting the market back to a slight surplus situation will obviously ease the upward pressure on prices. Back then, a similar situation triggered price hikes below the rate of inflation. Condo prices should slow below the 2% mark in 2013, and even decline somewhat in some sectors.

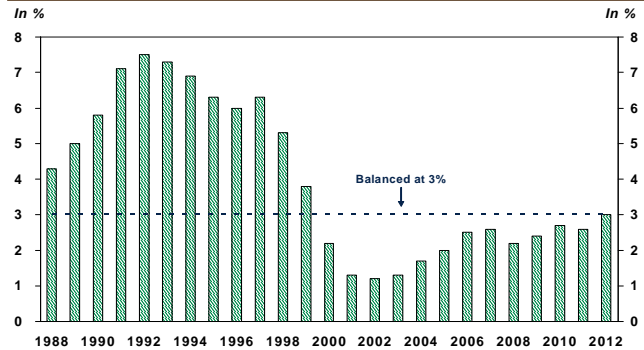
We do not expect to see a widespread drop in Quebec’s residential real estate prices. Condo purchases account for only 20% of sales in the province (30% in Montreal) since the market is dominated by single-family homes. And yet a small, stubborn shortage exists for this type of housing, with annual price changes hovering around 3%. In 2013, the pace at which prices will increase for all types of homes will be similar to the expected rate of inflation, or between 2% and 2.5%. Homes will set the pace for the state of the overall resale market since condos do not weigh heavily enough in the balance, despite extensive construction in recent years.

NEW CONSTRUCTION SET TO DECLINE

Housing starts have weakened in the past two years. Construction of single-family dwellings fell due to less-than-stellar demand from buyers for new homes: higher costs for construction and land, which is getting increasingly scarce closer to major centres, contributed to reducing demand. This trend will continue. In 2013, 15% fewer homes will be built in Quebec.

In terms of rental units, the market is back to equilibrium. The vacancy rate in 2012 reached 3%, bringing an end to the 10-year shortage that had prevailed (graph 3). The construction of conventional rental units, which has been relatively weak for several years, will slip again in 2013. Note that weak rents make it difficult for developers to build profitable projects, with the exception of the high-end market.

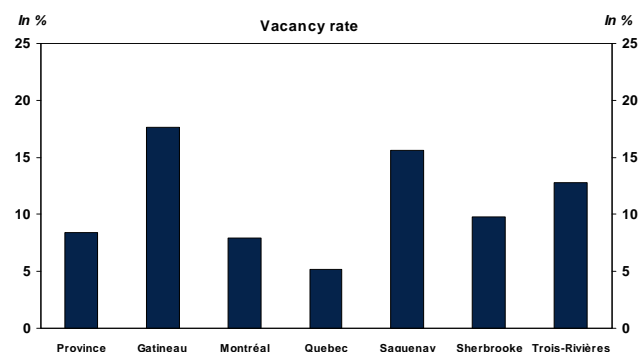
Graph 3 – The vacancy rate for rental units in Quebec is back to equilibrium



Sources: Canada Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

The construction of seniors’ residences is also not poised to move upwards. The rush of new projects in the early 2000s quickly led to major surpluses that have been slow to decrease (graph 4). With a vacancy rate of 8.4% in the province of Quebec and well beyond this level in certain CMAs, this market segment is clearly struggling. While Quebec’s population is aging, the number of senior citizens aged 75 and over has fallen in recent years. The cohort of baby-boomers is now reaching the age of 65, and the surge of people in this age group is fuelling the condominium market.

Graph 4 – The seniors’ residences market is in a surplus situation

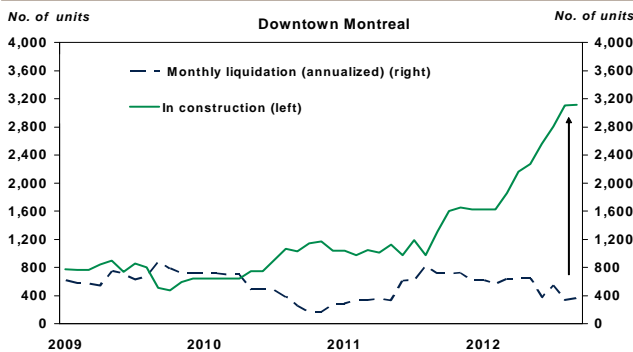


Sources: Canada Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

Even if the demographic trends have been favourable to the condo market for the past few years, robust construction seems to have been enough to meet demand. While the potential is still good in some sectors and in certain price ranges, the time has come for builders to put the brakes on new construction.

In downtown Montreal, construction projects have multiplied recently while demand for new condos seems to have stabilized (graph 5). More than 3,000 units are currently under construction, twice last year's rate at this time! A good portion of these units have already found takers, however. Before any work can begin, at least 55% of apartments have to be under a sales contract for the developer to be able to borrow from a financial institution. Buyers have to be found for the remaining 45% of units, ideally before construction is completed. Several projects will be wrapping up throughout 2013, allowing us to better assess how Montreal's market will be absorbed. The wave of new condos that will soon hit the market, with resales showing a slight surplus in Montreal and Quebec City, just may be the last straw that breaks the camel's back.

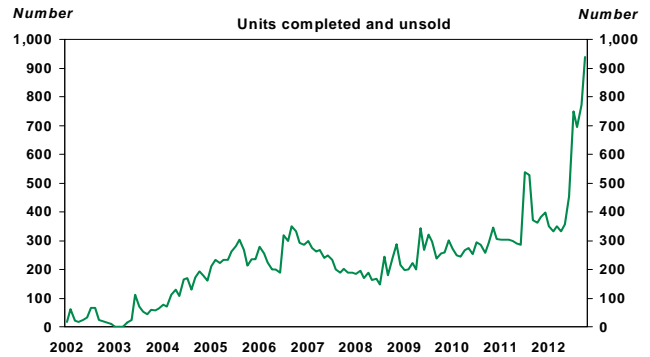
Graph 5 – Gap widening between condo construction (supply) and the no. of units sold¹ (demand)



¹ No. of units sold (12-month moving average)
Sources: Canada Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

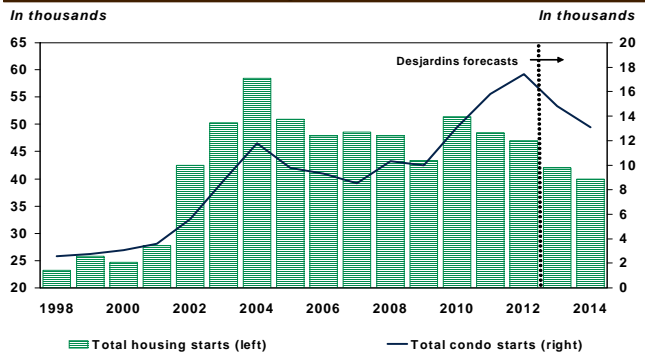
The situation in Quebec City is also becoming worrisome: condo starts climbed by 30% last year and almost 1,000 new condos remain unoccupied (graph 6). New condo construction in Quebec City and Montreal has got to pull back to make it easier to liquidate the new projects. Condo starts will decline by about 15% in Quebec this year and the construction of other types of housing will also wind down. In total, the market will grow by about 42,000 new dwellings in 2013, signalling a return to more normal conditions after the frenzy of the past few years (graph 7).

Graph 6 – Many new condos have yet to find takers in the Quebec CMA



Sources: Canada Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

Graph 7 – Condo construction will set the tone for housing starts in Quebec



Sources: Canada Mortgage and Housing Corporation (CMHC) and Desjardins, Economic Studies

In short, the soft landing in the residential sector will continue, and the condo market will be under close watch. Any obvious sign of less steady demand just when the supply of available units is overabundant may mean that an adjustment is in order, one that could last for at least two years.

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Senior Economist

Québec - Housing Market Outlook 2013-2014

| | 2010 | 2011 | 2012 | 2013f | 2014f |
|--|---------------|---------------|---------------|---------------|---------------|
| New Housing Market | | | | | |
| New construction (in billion \$) | 9.8 | 10.2 | 10.2 | 9.7 | 9.5 |
| Annual variation (%) | 17.1 | 3.3 | 0.7 | -5.3 | -2.1 |
| Housing starts | 51,363 | 48,387 | 47,367 | 42,000 | 40,000 |
| Annual variation (%) | 18.3 | -5.8 | -2.1 | -11.3 | -4.8 |
| House | 25,937 | 22,411 | 21,829 | 18,700 | 19,000 |
| Annual variation (%) | 14.7 | -13.6 | -2.6 | -14.3 | 1.6 |
| - Single-detached | 19,549 | 16,554 | 16,059 | - | - |
| Annual variation (%) | 11.5 | -15.3 | -3.0 | - | - |
| - Semi-detached | 4,359 | 4,002 | 3,866 | - | - |
| Annual variation (%) | 26.8 | -8.2 | -3.4 | - | - |
| - Row housing unit | 2,029 | 1,855 | 1,904 | - | - |
| Annual variation (%) | 24.2 | -8.6 | 2.6 | - | - |
| Apartment | 25,426 | 25,976 | 25,538 | 23,300 | 21,000 |
| Annual variation (%) | 22.3 | 2.2 | -1.7 | -8.8 | -9.9 |
| - Condo¹ | 13,111 | 15,827 | 16,017 | 13,500 | 12,200 |
| Annual variation (%) | 31.3 | 20.7 | 1.2 | -15.7 | -9.6 |
| - Rental¹ | 11,032 | 9,055 | 8,437 | 8,500 | 8,000 |
| Annual variation (%) | 16.1 | -17.9 | -6.8 | 0.7 | -5.9 |
| - Conventional rental² | 6,941 | 5,536 | 5,455 | 4,700 | 4,700 |
| Annual variation (%) | 10.7 | -20.2 | -1.5 | -13.8 | 0.0 |
| - Retirement home² | 2,869 | 2,370 | 1,885 | 1,900 | 2,000 |
| Annual variation (%) | 30.2 | -17.4 | -20.5 | 0.8 | 5.3 |
| Resale market | | | | | |
| Unit sales | 80,027 | 77,171 | 77,463 | 73,500 | 74,000 |
| Annual variation (%) | 1.2 | -3.6 | 0.4 | -5.1 | 0.7 |
| Weighted average price (in thousand \$) | 249 | 261 | 271 | 277 | 284 |
| Variation annuelle (%) | 8.0 | 5.1 | 3.9 | 2.2 | 2.5 |
| Sales volume (in billion \$) | 19.3 | 19.5 | 20.2 | 20.4 | 21.0 |
| Annual variation (%) | 8.4 | 0.7 | 3.7 | 1.0 | 3.2 |
| Other indicators | | | | | |
| Vacancy rate for rental units³ (%) | 2.7 | 2.6 | 3.0 | 3.2 | 3.1 |
| Average rent³ (in \$) | 648 | 665 | 670 | 678 | 686 |
| Annual variation (%) | 4.0 | 2.6 | 0.7 | 1.3 | 1.2 |
| Renovation spending (in billion \$) | 14.1 | 15.0 | 15.2 | 15.3 | 14.9 |
| Annual variation (%) | 0.5 | 6.0 | 1.7 | 0.7 | -2.6 |

¹ Urban centres with populations of 10,000 and over. The total is slightly below the total for provincial apartments shown above.

² Included in rental units.

³ Three units or more. Biannual survey of the fall.

Sources: Canada Mortgage and Housing Corporation, Canadian Real Estate Association, Québec Federation of Real Estate Boards, Statistics Canada and Desjardins, Economic Studies