SPOTLIGHT ON HOUSING

Quebec's housing market picks up steam

In spite of the stricter rules implemented by the federal government last fall on mortgage loans, Quebec's housing market has been improving while the market in Ontario continues to soar. Sales of existing properties are up and price growth is gaining momentum. The number of housing starts in Quebec is growing while the number of new and unsold condos has fallen sharply, which points to a modest construction recovery in this segment. The favourable economic situation for households, which relies on strong job creation and tax relief, is infusing new energy in Quebec's residential sector. We have as a result upgraded our forecasts for this year and next.

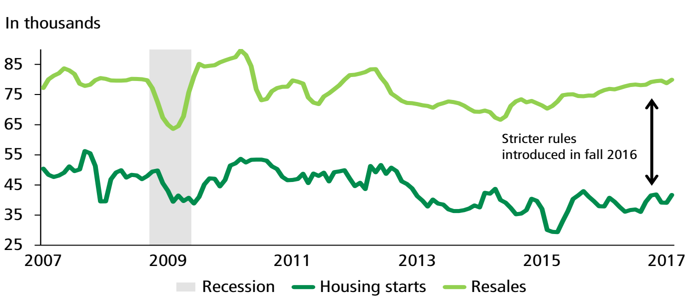
Positive backdrop for households

In October 2016, when the federal government announced that it was tightening the criteria for residential mortgage loans for borrowers with low down payments (box on page 3), concerns swirled about the negative impact this could have on Quebec's housing market. Worth noting, several successive tightening measures have been put in place since 2008. At that time, the maximum amortization period was cut from 40 years to 35 and the minimum down payment was increased from 0% to 5%. Then happened a serious slowdown in the resale market and new construction. It also collided with the 2008–2009 recession (graph 1) triggered by the real estate meltdown in the United States and the financial crisis that followed. This time, the residential sector, especially in Quebec and Ontario, held its own against these new measures; the economy is doing well and the context for households is particularly favourable.

Quebec's labour market improved greatly last year, with the strongest growth in full-time jobs since 2007 (graph 2). The unemployment rate even slipped below 6.5% at the end of 2016, a threshold that goes back about 40 years. Income growth was also fuelled by tax relief, such as the universal child care benefit, federal tax cuts and the total elimination of the Quebec health care contribution in 2017. All told, after tax and inflation, household income grew the most since the last recession. This strengthened the housing market that resisted the restrictions the new mortgage rules created.

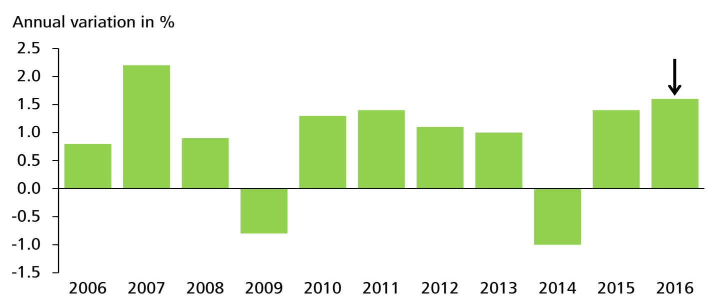
Sales of existing properties were up 5.5% in 2016 while average price growth was about 3%, and 2017 got off to a strong start. There are more purchases and fewer homes for sale. Annual price advances have been nearing 4% for the past few months (graph 3 on page 2). This renewed energy in the resale market

GRAPH 1
The federal government's new measures failed to slow residential activity in Quebec



Sources: Canadian Real Estate Association, Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

GRAPH 2
Full-time jobs posted solid advances in 2016



Sources: Statistics Canada and Desjardins, Economic Studies

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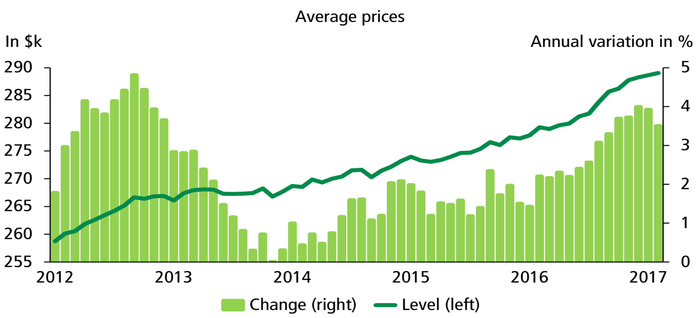
GRAPH 3
Property price increases accelerated



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

should continue in 2017 and generate a slight uptick in new construction by extension (table 1). The caution that reigned last fall before the more restrictive measures for mortgage loans were introduced has given way to a sense of optimism.

TABLE 1
Quebec's residential sector: activity to remain moderate

	2016	2017f	2018f
Number of sales *Variation in %*	78,172 *+5.5*	80,000 *+2.3*	81,000 *+1.3*
Current listings (% change)	-5.0	---	---
Average price ($) *Variation in %*	283,288 *+2.9*	293,300 *+3.5*	300,000 *+2.3*
Housing starts *Variation in %*	38,935 *+2.7*	40,000 *+2.7*	39,000 *-2.5*

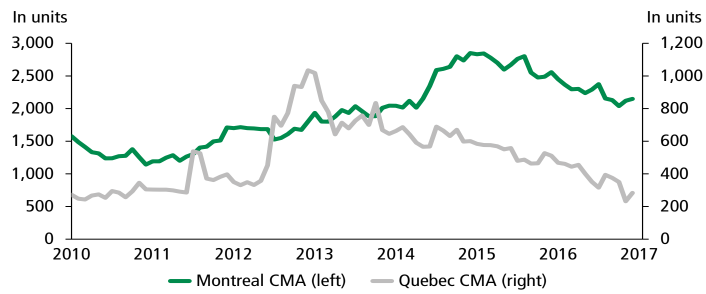
f: Desjardins forecasts
Sources: Québec Federation of Real Estate Boards via Centris,® Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

Surprising upswing in new construction

Housing starts for single-family homes jumped by more than 10% in 2016 after five straight years of decreases. The relative scarcity of properties for sale on the resale market prompted many buyers to turn to new construction. The market in Greater Montreal gave the upper hand back to sellers when shifts in the balanced market created a slight shortage. Given that demand for houses remains firm in most of the province's large urban centres, construction should continue to climb this year. Experienced buyers, who usually have enough of a down payment to be unaffected by the stricter mortgage rules, will keep the market afloat.

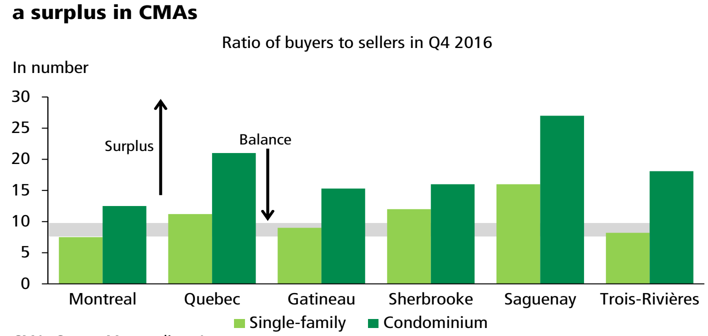
The decline in the construction of condo apartments since 2015 helped absorb the surplus situation that prevailed for years in the province's urban centres. The number of condos built and unsold has decreased, especially in Montreal and Quebec (graph 4). The market for new builds rests on a healthier if somewhat still fragile foundation. The surplus situation for existing condos is persistent in the province's six Census Metropolitan Areas (CMA) (graph 5), but the imbalance has eased. Even if it is still too early to say that construction in this segment is experiencing a widespread recovery, some well-positioned projects should spark buyers' interest fairly quickly. A slight rebound in the construction of condo apartments could occur in 2017.

GRAPH 4
The number of new unsold condos has declined in Quebec and Montreal CMAs



CMA: Census Metropolitan Area
Sources: Canadian Mortgage and Housing Corporation and Desjardins, Economic Studies

GRAPH 5
Unlike single-family homes, the resale condo market still shows a surplus in CMAs



CMA: Census Metropolitan Area
Sources: Québec Federation of Real Estate Boards via Centris,® and Desjardins, Economic Studies

The boom in rental apartment construction that began in 2015 is starting to run out of steam. New projects are having more trouble finding tenants than they were when this new wave of construction began, and developers are adjusting to this new reality. Housing starts have been idling for a few months while signs of saturation in the conventional rental market have been seen for some time now. In 2015, the vacancy rate was already above the 3% equilibrium point in Quebec's six metropolitan areas. Four now have vacancy rates above 6%, which can be linked to over-construction (graph 7 on page 3). In the Quebec CMA, 4.9% of apartments remain vacant compared

BOX

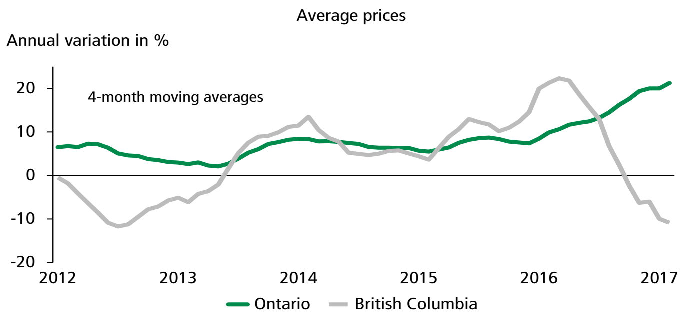
The change is designed to protect borrowers if mortgage rates start to rise. It applies to borrowers whose down payment is less than 20% of the property value, who must also take out mortgage loan insurance. For a five-year rate, the calculations for mortgage loan approval now use the rate set by the Bank of Canada instead of the rate offered by a financial institution. This method already applied for fixed rates of less than five years and for variable rate mortgages. As such, regardless of the term, the borrower must qualify for a higher interest rate even if the rate granted on the loan is in fact lower. This measure gives households some financial wiggle room should interest rates start to climb.

The cold shower effect expected to hit the real estate market in Quebec and Ontario never materialized. The favourable labour market and broader economy helped prevent a slowdown. That said, residential activity plummeted in Vancouver after the provincial government in British Columbia applied a 15% tax on purchases made by foreign investors.[1] The Ontario government could soon announce a similar measure to cool the stratospheric rise in sales and prices (graph 6). This hypothesis supports our forecasts that call for a slowdown in Ontario's residential sector (table 2). In Montreal, where advances in real estate sales and prices remain moderate and foreign investors are few and far between, such a tax would be unsuitable.

[1] The new tax had a strong impact on the Vancouver real estate market in August, Desjardins, Economic Studies, *Economic News*, September 15, 2016, 1 p.

GRAPH 6

The tax in British Columbia triggered a price correction; Ontario could soon suffer the same fate



Sources: Canadian Real Estate Association and Desjardins, Economic Studies

TABLE 2

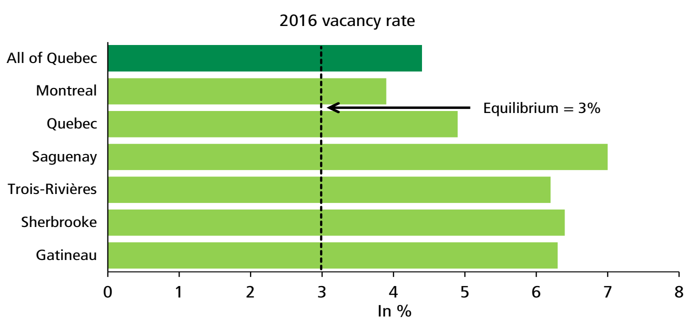
Ontario's residential sector: From hot to cool

	2016	2017f	2018f
Number of sales *Variation in %*	242,697 *+9.7*	254,589 *+4.9*	241,351 *-5.2*
Current listings (% change)	-6.3	---	---
Average price ($) *Variation in %*	534,730 *+15.3*	596,759 *+11.6*	587,211 *-1.6*
Housing starts *Variation in %*	74,952 *+6.8*	82,500 *+10.1*	69,400 *-15.9*

f: Desjardins forecasts
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 7

The rental apartment market is in surplus in all Quebec CMAs



CMA: Census Metropolitan Area
Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

with 3.9% in the Montreal CMA. Housing starts for rental units should, in theory, fall in the province as of 2017.

Brief outlook

The renewed activity in Quebec's resale market should continue over the next few months and have a positive impact on starts for new houses, which are set to rise for the second consecutive year. A slight rebound in condo apartment construction is also in the cards this year, given the large drop in the inventory of unsold units. Caution is in order for the rental segment due to the relatively high vacancy rate in Quebec's main urban centres. Overall, the level of housing starts should reach 40,000 this year, compared with the 38,935 new dwellings built in 2016.

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TABLE 3

Quebec Housing Market Outlook 2017–2018

	2014	2015	2016	2017f	2018f
New Housing Market					
New construction ($B)	**6.3**	**5.8**	**5.9**	**6.0**	**5.9**
Annual variation (%)	-3.9	-7.8	1.5	1.7	-1.7
Housing starts	**38,810**	**37,926**	**38,935**	**40,000**	**39,000**
Annual variation (%)	2.8	-2.3	2.7	2.7	-2.5
House	**15,707**	**13,593**	**15,435**	**16,500**	**16,800**
Annual variation (%)	-8.1	-13.5	13.6	6.9	1.8
Single-detached	***11,227***	***9,698***	***10,737***	---	---
Annual variation (%)	*-14.6*	*-13.6*	*10.7*	---	---
Semi-detached	***3,083***	***2,650***	***2,761***	---	---
Annual variation (%)	*8.7*	*-14.0*	*4.2*	---	---
Row housing unit	***1,397***	***1,245***	***1,937***	---	---
Annual variation (%)	*24.6*	*-10.9*	*55.6*	---	---
Apartment	**23,103**	**24,333**	**23,500**	**23,500**	**22,200**
Annual variation (%)	11.8	5.3	-3.4	0.0	-5.5
Condo [1]	***12,893***	***9,571***	***7,849***	***8,100***	***8,500***
Annual variation (%)	*13.1*	*-25.8*	*-18.0*	*3.2*	*4.9*
Rental [1]	***8,939***	***13,588***	***14,105***	***13,700***	***12,500***
Annual variation (%)	*7.3*	*52.0*	*3.8*	*-2.9*	*-8.8*
Conventional rental [2]	***6,204***	***9,218***	***10,552***	***10,200***	***9,200***
Annual variation (%)	*-6.5*	*48.6*	*14.5*	*-3.3*	*-9.8*
Retirement home [2]	***2,438***	***4,089***	***3,443***	***3,500***	***3,300***
Annual variation (%)	*72.8*	*67.7*	*-15.8*	*1.7*	*-5.7*
Resale market					
Unit sales	**70,620**	**74,122**	**78,172**	**80,000**	**81,000**
Annual variation (%)	-0.8	5.0	5.5	2.3	1.3
Weighted average price ($k)	**271**	**275**	**283**	**293**	**300**
Annual variation (%)	1.3	1.5	2.9	3.5	2.3
Sales volume ($B)	**18.8**	**20.2**	**22.1**	**23.5**	**24.3**
Annual variation (%)	0.4	7.5	9.8	6.0	3.6
Other indicators					
Vacancy rate for rental units [3] **(%)**	**3.7**	**4.3**	**4.4**	**4.6**	**4.5**
Average rent [3] **($)**	**691**	**712**	**727**	**741**	**756**
Annual variation (%)	1.8	3.0	2.1	1.9	2.0
Renovation spending [4] **($B)**	**12.2**	**12.7**	**12.5**	**12.8**	**13.0**
Annual variation (%)	6.3	4.0	-1.5	2.4	1.6

f: forecasts; [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; [4] Maintenance and repair expenditures are excluded.
Sources: Canada Mortgage and Housing Corporation, Canadian Real Estate Association, Quebec Federation of Real Estate Boards, Statistics Canada and Desjardins, Economic Studies