

H

OUSING MARKET

OUTLOOK

Montréal

Canada Mortgage and Housing Corporation

www.cmhc.ca

SPRING-SUMMER 2005

Housing market activity to decline in 2005

Economic overview

Global economy going full tilt

Drawn by the United States and China, which account for 40 per cent of the world's growth, the global economy posted very strong growth (4.8 per cent) in 2004. However, a tighter monetary policy south of our border and a reduced pace in China will result in a slowdown in global economic growth in 2005 and 2006.

The vigorous global production put strong upward pressure on the prices of raw materials, which attained a very high level. Let's consider, for example, the changes in the price of oil last fall. Since Canada is a major resource supplier, the price increase considerably strengthened the Canadian dollar in 2004. However, it was more the depreciation of the U.S. dollar, caused by the double trade and budget deficit, that buoyed up the loonie, which stayed above US\$0.80.

Housing market benefits from rise in Canadian dollar

The main impact of the strength of our dollar was unquestionably the slowdown in Canadian exports in the fourth quarter of 2004. During this period, Canada's GDP increased at an annualized rate of only 1.7 per cent, which was well below the annual average of 2.8 per cent. The strength of our loonie also brought about certain positive effects, such as a reduction in the price of imported products. In addition, the fact that the strong dollar put the breaks on our economy held back inflation and thereby put an end to the rise in interest rates, which greatly stimulated the housing market everywhere across the country (residential investments were up by 7 per cent in the fourth quarter).

In 2005, a slightly weaker Canadian dollar, resulting from the growing gap

IN THIS ISSUE

1 ECONOMIC OVERVIEW

Global economy going full tilt

Housing market benefits from rise in Canadian dollar

Quebec economy

Mortgage rates stay low

2 NEW HOME MARKET

Housing starts level remains very high

Freehold homes: a sure value

Condominiums enjoy considerable popularity

4 RESALE MARKET

Resale market begins downward course

New rise in listings firmly under way

Heading toward a balanced resale market in 2006

5 RENTAL MARKET

Vacancy rates continue to rise

6 FORECAST SUMMARY

between U.S. and Canadian interest rates, should lead to renewed export activity during the year. One month does not make a trend, but company shipments jumped up significantly in January, which looks promising for the external market.

Quebec economy

In Quebec, the situation is comparable to that which is prevailing on the Canadian scene, as consumer spending and business investment represent the two engines of economic growth. However, the province was harder hit by the repercussions of the strong Canadian dollar. In fact, Quebec has a larger proportion of jobs in the manufacturing sub-sectors that were directly affected by the drop in exports. As a result, in 2005, Quebec's GDP growth (+2.7 per cent) will be lower than Canada's (+3.0 per cent). In both cases, the growth will accelerate over 2004, thanks to the good performance of the

global economy and, more specifically, the U.S. economy.

As for employment, Quebec managed to do well, posting a gain of 1.5 per cent in 2004. It is important to note that the employment rate in Quebec has now reached 60.2 per cent, a historically high level that well reflects the good performance of the Quebec economy in the last few years.

In Montréal, the employment scenario was the same as in the rest of the province, with losses in the fourth quarter but a higher employment level for the year overall and a gain of 1.3 per cent in 2004. In addition, the first quarter of 2005 showed solid results, with gains of nearly 20,000 jobs. However, in the second half of 2004, there were several announcements of closures planned for the first six months of 2005. Consequently, the employment level is expected to rise by 1.1 per cent in Montréal and across the province, both in 2005 and 2006.

Mortgage rates stay low

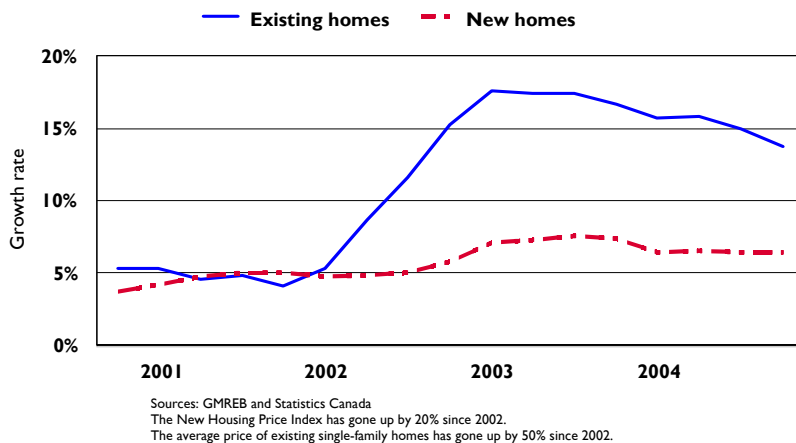
The appreciation of the Canadian dollar against the U.S. dollar held back economic expansion in the country and, by the same token, halted the key policy interest rate rise initiated by the Bank of Canada in 2004. This situation kept mortgage rates at historically low levels. And, there is every indication that this situation will last for several more quarters, as the anticipated rise in the rates will take place gradually and should only begin during the second half of the year. Our latest forecasts call for an increase at the end of 2005 that should continue throughout 2006. The average rate for a one-year term will therefore be 5.0 per cent at the end of this year and 5.6 per cent by the fourth quarter of 2006. The longer-term rate (five-year term), for its part, will attain levels of 6.3 per cent and 6.7 per cent, respectively, at the end of the fourth quarters of 2005 and 2006.

New home market

Housing starts level remains very high

Despite a small anticipated decline, residential construction will remain very strong in 2005 and 2006, in comparison with the expected household formation level (20,250)¹ and the number of housing starts recorded during the 1990s. The price increase on the resale market has made new homes more competitive. In fact, since the beginning of 2002, the average price of existing homes climbed by 50 per cent on the resale market, while the Statistics Canada New Housing Price Index shows an increase of 20 per cent for a typical home in the Montréal area (see Graph 1). This means that the price gap between existing and new homes has narrowed by nearly 30 per cent in the last three years.

Prices Rise by 30% More for Existing Homes



Graph 1

¹ Average annual household formation in the Montréal CMA between 2001 and 2006, forecast by the Institut de la statistique du Québec (ISQ).

As well, the resale market is still suffering from a lack of supply that is favouring sellers and inciting buyers to turn to other options. However, the price hikes observed in the last few years and the stabilization of the mortgage rates are directly affecting housing affordability in Greater Montréal. With the conditions to access homeownership having deteriorated, the new home market will gradually sustain the effects of this deterioration in 2005 (26,000 units, or -9 per cent) and 2006 (23,000 units, or -12 per cent).

Freehold homes: a sure value

With their space, tranquillity and privacy, freehold homes remain the favourite housing type of Greater Montréal area households. Starts of such homes (detached, semi-detached and row houses) will reach 11,250 units (-8 per cent) in 2005. This decrease and the further decline expected in 2006 (-7 per cent) will be due to the deterioration in affordability, caused by price increases above inflation and the new rise in mortgage rates anticipated for the end of the year.

Condominiums enjoy considerable popularity

Condominiums target diverse clients. On the one hand, with their affordable prices, they attract first-time home buyers who have difficulty in finding rental dwellings and, on the other hand, they also appeal to older households who seek luxury properties that require little maintenance and are smaller than their previous homes that they sold at high prices. Located both downtown and near the city's main attractions, condominiums have also made a significant breakthrough off the Island of Montréal. They can now be found in the first-crown suburbs (Laval, Longueuil, Brossard) and second-crown centres (Saint-Basile-le-Grand, Pincourt, Mascouche). Thanks to this socio-economic and geographical mix of clients, a new record was set in 2004, with 10,051 condominium starts. We are now forecasting the construction of 8,000 condominiums this year and 7,000 in 2006.

With this greatly segmented supply, the buyers' specific needs can be met.

However, this specificity results in a reduced number of potential buyers for each of the projects, such that they take longer to be absorbed. The first signs of change appeared in the summer of 2004, when the number of completed and unoccupied condominiums started to increase. In 2004, such available units jumped up by 110 per cent while, from 1997 to 2003, they had risen by just 5 per cent. This had a direct impact on the duration of supply, which doubled to three months. However, this figure remained well below the levels observed in the early 1990s (between five and seven months). The higher inventories and their longer duration are two elements suggesting that the record set last year will not be equalled in 2005. In addition, on the resale market, condominiums were the first housing type to have registered a new rise in active listings, which will cause this segment to rapidly move towards a better balance between sellers and buyers. On a less tight market, the price increases are less significant and buyers have more choice, two factors that will also affect demand for new units.

New Home Market - Freehold Homes

% Change, 2004 to 2005 and 2005 to 2006, by Submarket

Submarket	Starts			Change		Average Price (\$) - Detached			Change	
	2004	2005f	2006f	04/05	05/06	2004	2005f	2006f	04/05	05/06
Island of Montréal	869	800	770	-8%	-4%	434,413	485,000	510,000	12%	5%
Laval and North Shore	7,122	6,500	6,050	-9%	-7%	239,669	260,000	272,000	8%	5%
South Shore	3,049	2,900	2,700	-5%	-7%	240,884	265,000	277,000	10%	5%
Total Montréal Area*	12,177	11,250	10,500	-8%	-7%	251,365	275,000	289,000	9%	5%

* The sum of the submarkets does not correspond to the total for the metropolitan area on account of the MRC of Vaudreuil-Soulanges.

Source: CMHC

Resale market

Resale market begins downward course

In Greater Montréal, the number of transactions involving existing homes reached a peak in 2002, when 36,295 sales were made by member agents of the Greater Montréal Real Estate Board. However, the market can still be qualified as vigorous for a third straight year, as 36,022 transactions were recorded in 2004, for an increase of 2 per cent over the year before. But, even though activity has stabilized at the peak, the resale market is currently undergoing some major changes that will inevitably affect the level of transactions and the rise in prices in 2005 and 2006.

The price increase observed since 2002 (average hike of 53 per cent for freehold homes between 2001 and 2004) is the main factor accounting for the anticipated slowdown in sales. The decrease in mortgage rates from 2002 to 2004 effectively subsidized the increase in values. However, the fact that interest rates have stabilized in the last few quarters and are now expected to rise slightly means that households will no longer be able to pay more for their homes while sustaining a lower increase in their monthly payments—an increase of 30 per cent for the average monthly payment on a freehold home, between 2001 and 2004 (see Graph 2). In fact, it can be seen that, since the end of 2004, for all housing types, the price changes are fully reflected in the monthly payments, which will greatly affect accessibility over the coming years. We are therefore forecasting that the resale market will sustain a decrease of 7 per cent this year, to a total of 33,500 transactions, and a further drop of 4 per cent next year, to 32,000 sales.

New rise in listings firmly under way

Active listings have been on the rise since the second half of 2003. In addition to the fact that this new rise has now been firmly under way for almost two years, the pace at which listings have been accumulating has been steadily picking up every quarter. At the end of 2004, supply had increased by 30 per cent over the previous year. This sharp increase in homes for sale has been attributable to the rise in prices observed in recent years. And, since there is no risk that prices will be coming back down, listings will post a significant rise of 32 per cent in 2005, before slowing down the pace in 2006 (+18 per cent).

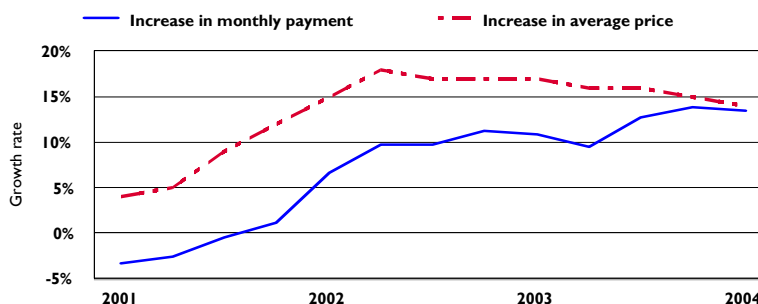
The increase in supply is welcome by buyers who are thereby seeing their choice and negotiating power increase. In fact, the market has been favourable to sellers for the past four years, as the number of listings per sale has been below the balanced range established at between 8 and 10. The slowdown in sales, combined with the new rise in listings, has now brought up the numbers of listings for

every sale, which had remained stable for several quarters. For plexes and freehold homes, the number of listings per sale rose from 4 to 5 at the end of the year. Since condominium listings have risen more steadily, the number of listings per sale for this housing type went up from 4 to 6 within a few months.

Heading toward a balanced resale market in 2006

At the rate the market is currently evolving, we expect that condominiums will be the first housing type to reach the balanced range, by the end of 2005. In this more balanced context, the increase in prices will slow down and gradually ease toward the level of inflation. We are consequently forecasting that the average price of condominiums will rise by 4 per cent in 2005 and by 3 per cent next year. As for freehold homes and plexes, they will reach the balanced range only in 2006, given that their listings are rising more slowly. Since these market segments will continue to favour sellers this year, these housing types should post price hikes of 7 per cent and 8 per cent, respectively, and then 4 per cent in 2006.

Monthly Payment Increase Reaches Price Hike



Sources: CMHC and GMREB
10% down, 25-year term
Smoothed data

Graph 2

Resale Market - Freehold Homes

% Change, 2004 to 2005 and 2005 to 2006, by Submarket

Submarket	Sales			Change		Average Price (\$)			Change	
	2004	2005f	2006f	04/05	05/06	2004	2005f	2006f	04/05	05/06
Island of Montréal	5,483	5,300	5,150	-3%	-3%	302,859	320,000	330,000	6%	3%
Laval and North Shore	9,136	8,600	8,300	-6%	-3%	175,481	188,000	195,000	7%	4%
South Shore	6,736	6,400	6,150	-5%	-4%	185,070	202,000	210,000	9%	4%
Total Montréal Area*	22,634	21,500	20,750	-5%	-3%	211,645	227,000	237,000	7%	4%

* The sum of the submarkets does not correspond to the total for the metropolitan area on account of the MRC of Vaudreuil-Soulanges.

Source: CMHC, GMREB

Rental market

Vacancy rates continue to rise

The housing shortage that hit the Montréal area with full force is no longer what it was three years ago. In October 2001, at the height of the shortage, the vacancy rate for privately initiated housing units reached 0.6 per cent. According to the results from this past October, the proportion of vacant units was 1.5 per cent in the Montréal CMA. The situation remains difficult for many renter households. However, since they are better informed of the situation, they start looking for new apartments sooner, and this softens the impact when July 1st comes.

The rise in the vacancy rate has resulted from the combined effect of several factors and, since these factors are still present on the market, this trend will continue in 2005 and 2006. We are forecasting that the vacancy rate will go up by 0.7 of a percentage point to 2.2 per cent next October. In 2006, the increase will be smaller, and 2.7 per cent of units will be vacant.

The first explanatory factor is the rising supply of new units. Rental housing starts went up from 1,669 units in 2001 to 6,443 in 2004. This year, the market should maintain the pace, with 6,750 new rental units, for

an increase of 13 per cent. In 2006, the number of starts will decrease, given the end of certain government programs and the slowdown in retirement apartment construction.

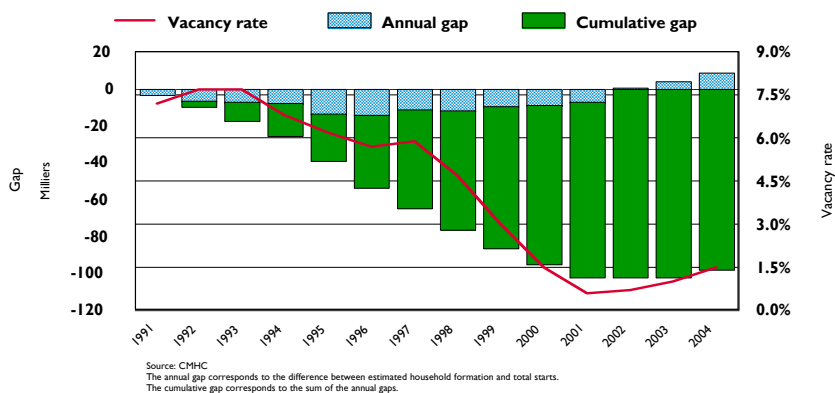
Second, the wish to access homeownership remains present among renter households. In recent years, declining mortgage rates and affordable prices for houses and condominiums have strongly stimulated homeownership, which has freed up many rental dwellings. Despite the deterioration in affordability caused by the major price hikes, renter households still account for a significant share of active buyers.

In sum, although our forecasts call for decreases in 2005 and 2006, total units built (26,000 in 2005) will still exceed household formation in

Greater Montréal (around 20,250 annually from now until 2006, according to the ISQ). This anticipated difference will affect the rental market, causing the vacancy rate to rise again. In fact, since the beginning of the 1990s, the sum of the gaps between these two indicators very well reflects the changes on the rental market (see Graph 3). The rental market therefore constitutes a buffer market that moves inversely to the homeownership trend.

As for the average rent, landlords will be setting rent increases above inflation (target rate of 2 per cent) over the next two years. In fact, we are forecasting that the rent for a two-bedroom apartment will rise by 3.0 per cent in 2005 and by 2.5 per cent in 2006, compared to 3.3 per in 2004.

Positive Gap Between Construction and Household Formation Eases Rental Market Conditions



Graph 3

Forecast Summary Montréal Census Metropolitan Area Spring-Summer 2005

	2003	2004	2005f	2006f	Change	
					2004/2005	2005/2006
RESALE MARKET ¹						
MLS® sales						
Total	35,323	36,022	33,500	32,000	-7%	-4%
Freehold	22,387	22,634	21,500	20,750	-5%	-3%
Condominium	7,345	7,927	7,250	6,875	-9%	-5%
Plex (2 to 5 units)	5,591	5,461	4,750	4,375	-13%	-8%
Active MLS® listings						
Total	11,418	14,800	19,500	23,000	32%	18%
Freehold	7,136	8,856	11,500	13,500	30%	17%
Condominium	2,349	3,646	5,000	6,000	37%	20%
Plex (2 to 5 units)	1,933	2,298	3,000	3,500	31%	17%
Average MLS® price (\$)						
Freehold	185,883	211,645	227,000	237,000	7%	4%
Condominium	164,804	181,978	189,000	194,000	4%	3%
Plex (2 to 5 units)	226,852	264,459	286,000	299,000	8%	5%
NEW HOME MARKET						
Starts						
Total	24,321	28,673	26,000	23,000	-9%	-12%
Freehold	11,702	12,177	11,250	10,500	-8%	-7%
Condominium	7,893	10,053	8,000	7,000	-20%	-13%
Rental	4,726	6,443	6,750	5,500	5%	-19%
Average price (\$)						
Detached	219,977	251,365	275,000	289,000	9%	5%
Semi-detached	171,955	188,786	200,000	206,000	6%	3%
New Housing Price Index*	1.27	1.35	1.42	1.48	5%	4%
RENTAL MARKET (%)						
Vacancy rate (October)	1.0	1.5	2.2	2.7	--	--
Change in rents (2-bedroom)	4.1	3.3	3.0	2.5	--	--
ECONOMIC OVERVIEW						
Mortgage rate - 1-year (%)	4.8	4.6	5.0	5.6	--	--
Mortgage rate - 5-year (%)	6.4	6.2	6.3	6.7	--	--
Annual employment level (thousands)	1,816	1,810	1,830	1,850	1%	1%
Unemployment rate (%)	9.5	8.6	9.0	9.0	--	--

¹ The publication of MLS® data is made possible thanks to the collaboration of the Greater Montréal Real Estate Board.

* The New Housing Price Index represents the changes in the selling price charged by builders for the same house from one month to the next, while the average price reflects all the homes absorbed by the market.

f: CMHC forecasts

Sources: CMHC, GMREB and Statistics Canada

© 2005 Canada Mortgage and Housing Corporation. All rights reserved. No portion of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, mechanical, electronic, photocopying, recording or otherwise without the prior written permission of Canada Mortgage and Housing Corporation. Without limiting the generality of the foregoing, no portion of this publication may be translated from English into any other language without the prior written permission of Canada Mortgage and Housing Corporation. The information, analyses and opinions contained in this publication are based on various sources believed reliable, but their accuracy cannot be guaranteed. The information, analyses and opinions shall not be taken as representations for which Canada Mortgage and Housing Corporation or any of its employees shall incur responsibilities.