HOUSING MARKET OUTLOOK

Québec

Canada Mortgage and Housing Corporation

www.cmhc.ca

SPRING 2006

Economic and Demographic Context: a Little Sand in the Gears

Gradually rising mortgage rates and much more modest employment growth in the Québec area will contribute to weakening the housing market over the 2006-2007 period. In addition to these less favourable indicators, demographic growth will be increasingly weaker and net migration will decrease slightly on account of a less attractive job market. No sharp decrease in activity is to be expected, however, as mortgage rates will still be relatively low, no job losses are anticipated and net migration will remain positive. The turnaround in the trends will therefore take place slowly.

Mortgage rates will continue the rising trend that began a few quarters ago already. Despite this upward movement, the rates will stay relatively low, and the anticipated increases will be moderate. In fact, tempered inflation and the strength of the Canadian dollar against the U.S. currency will limit the extent and pace of the increase in mortgage rates.

From now until the end of 2006, rates will rise gradually, gaining 50 to 75 basis points. The posted one-year, three-year and five-year mortgage rates will range from 5.75 per cent to 6.75 per cent, from 6.00 per cent to 6.75 per cent and from 6.25 per cent to 7.25 per cent, respectively. The increase will be smaller in 2007, as mortgage rates should go up by no more than 25 basis points compared to their 2006 annual averages.

Following an exceptional year in 2005, the Québec census metropolitan area (CMA) labour market will evolve at a much more modest pace in 2006 and 2007. In fact, after a gain of more than 14,000 jobs in 2005 (+4 per cent), it is expected that 3,000 positions will be created in 2006 and 4,000 in 2007. The unemployment rate should go back up slightly. Since changes on the job market generally affect the housing market about six quarters later, the good performance observed in 2005 will have a positive impact in 2006 and early 2007. This will not be sufficient, though, to offset the negative effects of the other economic and demographic indicators, as well as the gradual rise in inventories of properties for sale and dwellings for rent.

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Among the factors explaining the more moderate employment growth are the rising interest rates and energy costs, which will slow down consumer spending. For manufacturing companies, the strength of the Canadian dollar and increased competition from foreign countries will also limit job creation. Activity in the construction sector, for its part, has been very vigorous in recent years thanks to the real estate boom, but will lose strength.

Resale Market: Sales to Stay High but Price Growth to Moderate

The strong activity observed on the resale market in 2005 will continue in 2006, but at a slower pace. In all, 7,044 sales were recorded through the Service inter-agences / Multiple Listing Service (S.I.A. / MLS)® network in 2005, for an increase of 12.5 per cent. In 2006, the sales volume will rise slightly by 1.5 per cent and then fall by 2.1 per cent in 2007.

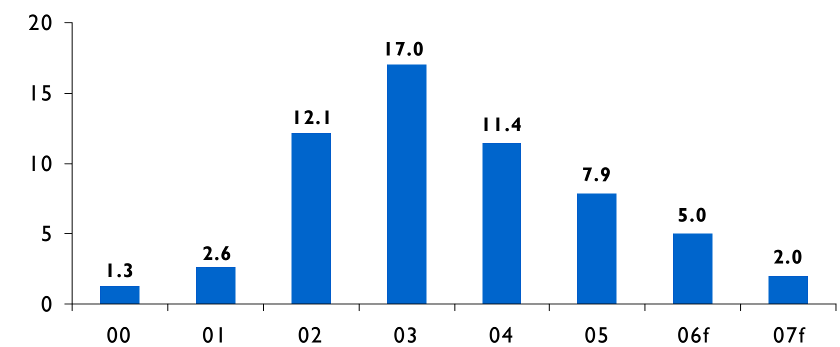
Despite the latest mortgage rate hikes that could curb the growth in housing demand, this demand will remain relatively stable in 2006 and 2007. The vigorous demand for existing homes has been partly attributable to the job creation in the Québec CMA, which was among the strongest in the province in 2005, and to the relatively low interest rate levels. Interest rates are rising gradually, but they are still at half the levels recorded during the 1990s. In addition, since sellers are confronted with a less dynamic market, where listing periods are getting longer, more homeowners are listing their homes for sale on the S.I.A. / MLS® network to benefit from better exposure on the market. In fact, listing periods averaged at 55 days in the first quarter of 2006, compared to 40 days at the height of the market in 2003. This partly explains why S.I.A. / MLS® listings rose in 2005 (+20 per cent), and similar increases are anticipated in 2006 and 2007. The median price of properties climbed by 8 per cent in 2005, but will rise more moderately in 2006 (+5 per cent) and 2007 (+2 per cent), because the supply of homes for sale listed on the S.I.A. / MLS® network will increase more rapidly than the demand.

As well, the resale market is increasingly diversified. Fifteen years ago, single-detached houses represented 74 per cent of the sales, while the share of condominiums was 9 per cent. In 2005, condominium transactions reached 19 per cent of S.I.A. / MLS® sales. The many condominiums built in recent years helped support the resale market. Condominium sales will rise by 2.7 per cent in 2006, a rate above the average for all housing types combined. The growth in prices, however, will be below the average for all housing types combined, on account of the relatively abundant supply of condominiums for sale. The seller-to-buyer of 7.6 to 1 observed in the first quarter of 2006 indicates that this market is practically balanced[1]. By comparison, this ratio was 5.5 to 1 for single-detached houses.

It can be seen that, the more expensive the properties, the more difficult the markets, with resulting higher seller-to-buyer ratios and longer listing periods. In fact, for single-detached, semi-detached and row homes priced at under $150,000, the seller-to-buyer ratios are barely 3 to 1 and the listing periods vary between 35 and 45 days,

Price Growth to Slow Down

Change in Median MLS® Price (%) – Québec Area



Source: Chambre immobilière de Québec, CMHC compilation and forecasts
f: forecasts

[1] It should be noted that, on a balanced market, which equally favours buyers and sellers, the seller-to-buyer ratio stands between 8 and 10 to 1. A ratio below 8 to 1 signifies a seller's market, while a ratio above 10 to 1 indicates a buyer's market.

indicating a continued overheating market, or extreme seller's market. Conversely, above the $200,000 mark, the seller-to-buyer ratios rise to 11 to 1 and the listing periods climb to 90 days, signifying a buyer's market. For condominiums, the trend is similar, but the indicators are higher in all price ranges, given the more abundant supply.

New Home Market: Starts to Keep Falling

After five years of growth, residential construction registered a first decline of 6 per cent in 2005. This downward trend will intensify slightly in 2006 and 2007, as starts volumes should reach 5,000 units in 2006 and 4,200 units in 2007, for decreases of 14 per cent and 16 per cent, respectively. Several factors are pointing to a slowdown. There are more and more existing properties for sale, particularly in the condominium segment, and the vacancy rates are going back up for both traditional and retirement rental housing. In addition, demographic growth is slowing, which is reducing the need to build new dwellings. However, since these factors are evolving gradually, the decline in starts will also be gradual over the 2006-2007 period.

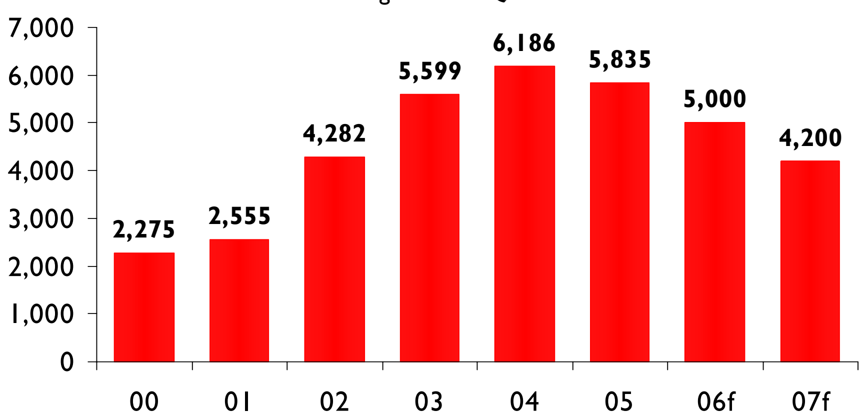
Freehold homes[2] are the least affected by the decrease in starts. The decline was effectively marginal in 2005 and will again be less significant than the drops registered in the other market segments in 2006, with an expected 3,000 starts (-9 per cent). Even if the market is easing, the context continues to favour sellers, and there is still a shortage of properties for sale on the market, which justifies the need to build new homes. However, the existing home market should find a certain balance again during the course of 2007, which will result in a more pronounced decline in construction. It is expected that 2,500 freehold homes will be started in 2007, or 17 per cent fewer than in 2006. Given the increasingly higher prices, the share of single-detached houses is tending to decrease in favour of semi-detached and row homes, which are generally less expensive, and duplexes, for which the rental income can help reduce the financial burden. The share of single-detached houses, which was around 90 per cent at the beginning of the decade, will fall back to about 75 per cent in 2006 and 2007.

The condominium market will be more affected by the slowdown in construction. The inventory of new unsold condominiums, which was practically non-existent at the beginning of 2003, stood at around 250 units in March 2006. In addition, there are close to 1,000 condominiums for sale on the S.I.A. / MLS® network. As mentioned earlier, the existing condominium market is now practically balanced. In this context, developers will demonstrate more caution, and starts should therefore fall to 850 units in 2006 (-25 per cent) and then to 750 units in 2007 (-12 per cent). While there is no cause for alarm for the moment, certain sectors should be watched more closely, as they are characterized by either an already balanced existing home market or a longer duration of supply[3] than on the new home market. These sectors are the Québec Haute-Ville and Basse-Ville districts, as well as Sainte-Foy and Lévis.

Rental housing construction will also slow down. There should be 1,150 starts in 2006 and 950 in 2007,

Residential Construction to Decline Further

Total Housing Starts – Québec Area



Source: CMHC
f: forecasts

[2] Freehold homes include detached, semi-detached and row houses, as well as duplexes.

[3] The duration of supply is the period (in months) required to absorb the units that are unoccupied or under construction.

for decreases of 19 per cent and 17 per cent, respectively. The gradual rise in the vacancy rates for traditional and retirement rental housing will limit the addition of new units. In the case of traditional units, the saturation of the existing upper-range market, particularly in the Sainte-Foy sector, and the impossibility to build privately initiated affordable housing will contribute to restricting construction. However, the decrease in activity will be tempered by social housing construction, which will be stronger in 2006 than in 2005.

As for retirement housing, the intense activity in recent months will no doubt restore a balanced situation in 2006, with a vacancy rate between 5 per cent and 6 per cent. It can therefore be expected that new retirement homes will arrive on the market at a more modest pace in 2006 and 2007.

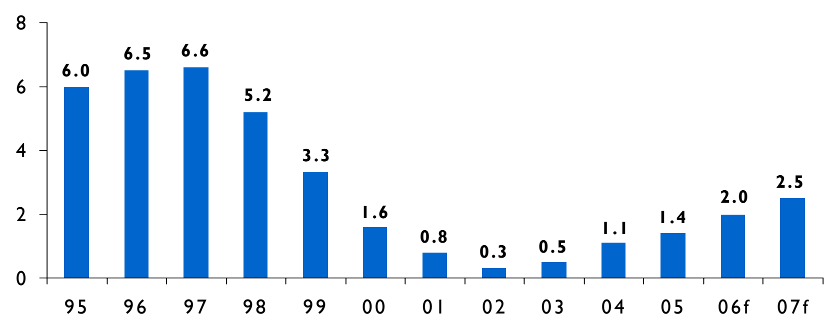
Rental Market :
More and More Available Units

The upward trend in the vacancy rate for traditional rental housing, which began in 2003, will continue this year and next. The vacancy rate, which was 1.4 per cent in October 2005, should therefore reach 2.0 per cent in 2006 and 2.5 per cent in 2007. The increase in the construction of rental and condominium housing in recent years and a weakening demand, particularly due to more moderate employment growth and the resulting slowdown in migration, explain this rise in the vacancy rate.

Just like on the resale market, conditions on the rental market vary significantly depending on the rent range. For two-bedroom units renting for $900 or over, there has been a surplus since 2004 and, in 2005, the vacancy rate reached 7.0 per cent. Although the vacancy rate is expected to decrease, given the few luxury units that will be arriving on the market, the surplus will persist in 2006 and 2007. In the case of the most affordable units (under $600), the opposite holds true, as the vacancy rate attained 0.6 per cent. Since the private sector cannot build housing units at this price, notably on account of overly high construction costs, the supply is growing very slowly. In the mid-range category ($600 to $899), the vacancy rate was 1.5 per cent in 2005. In this category, wood-and-brick structures can still be built. The vacancy rate should therefore continue to rise, particularly in the outlying sectors, where lands are better suited to the construction of lower-density wood-and-brick buildings. As the supply of units increases, the pressure on rents decreases. The rise in the average rent, which peaked at 4.5 per cent in 2004, slowed to 3.4 per cent in 2005. According to our forecasts, the average rent can be expected to increase by 2.5 per cent in 2006 and by 2.0 per cent in 2007.

Vacancy Rate to Keep Rising

Vacancy Rate (%) – Québec Area



Source: CMHC
f: forecasts

Forecast Summary
Québec Census Metropolitan Area
Spring 2006

	2004	2005	2006f	2007f	2005/2006	2006/2007
RESALE MARKET [1]						
MLS® sales						
Total	6,257	7,044	7,150	7,000	1.5%	-2.1%
Single-detached	3,962	4,415	4,500	4,400	1.9%	-2.2%
Semi-detached and row	887	943	950	930	0.7%	-2.1%
Condominium	1,123	1,363	1,400	1,370	2.7%	-2.1%
Duplex	285	323	300	300	-7.1%	0 %
Active MLS® listings						
Total (annual average)	2,609	3,186	3,825	4,500	20.1%	17.6%
Median MLS® price ($)						
Total	127,281	137,362	144,250	147,000	5.0%	1.9%
Single-detached	134,850	146,557	154,000	157,500	5.1%	2.3%
Semi-detached and row	112,534	121,435	127,500	130,500	5.0%	2.4%
Condominium	108,041	118,594	123,000	125,000	3.7%	1.6%
NEW HOME MARKET						
Starts						
Total	6,186	5,835	5,000	4,200	-14.3%	-16.0%
Freehold	3,311	3,284	3,000	2,500	-8.6%	-16.7%
Condominium	1,200	1,131	850	750	-24.8%	-11.8%
Rental	1,675	1,420	1,150	950	-19.0%	-17.4%
New Housing Price Index						
1997 = 100	129.3	134.9	141.6	146.6	5.0%	3.5%
RENTAL MARKET (%)						
Vacancy rate (October)	1.1	1.4	2.0	2.5	--	--
Change in rents (2-bedroom)	4.5	3.4	2.5	2.0	--	--
ECONOMIC OVERVIEW						
Mortgage rate - 1-year (%)	4.59	5.1	6.3	6.4	--	--
Mortgage rate - 5-year (%)	6.23	6.0	6.8	6.9	--	--
Employment level	363.4	377.6	380.5	384.5	0.8%	1.1%
Unemployment rate (%)	5.8	5.6	5.8	6.0	--	--

[1] *The publication of MLS® data is made possible thanks to the collaboration of the Chambre immobilière de Québec (CIQ).*

f: CMHC forecasts
Sources: CMHC, CIQ and Statistics Canada

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Together with other housing stakeholders, we help ensure that Canada maintains one of the best housing systems in the world. We are committed to helping Canadians access a wide choice of quality, affordable homes, while making vibrant, healthy communities and cities a reality across the country.

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