SPOTLIGHT ON HOUSING

The Real Estate Market Flurry in Quebec Will Subside: Signs of Calm Are Already Emerging

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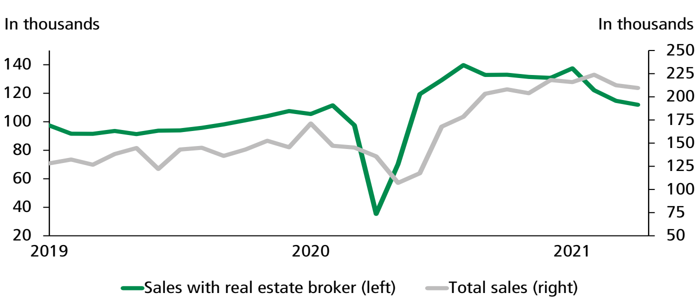
The residential real estate market is exceptionally hot. Existing home sales are very quick and new construction is strong. The unprecedented shortage of homes for sale, combined with sustained buyer demand, are putting heavy upward pressure on prices. As predicted at the beginning of the year, average prices for existing homes will increase approximately 20% in Quebec in 2021. The bidding war and multiple offer phenomenon, especially on the Island of Montreal and in neighbouring areas, is affecting mainly single-family homes. This situation will subside as the supply of properties for sale increases and demand eases in the future. A number of other factors will help cool the market, stabilizing prices starting next year.

Sales and New Construction Are Losing Steam

Even though activity is still very high, property sales have stopped climbing after catching up from spring 2020. However, strong buyer demand continues. The low inventory of available properties, near a historic low for not only single-family homes, but also condos and plexes, is curbing the number of sales in Quebec. Both real estate broker transactions and total sales, which include those without an intermediary, have been levelling off over the past few months (graph 1). Because of the residential market boom, many sales are made by mutual agreement between the seller and the buyer, accounting for approximately 30% of total sales in Quebec.

GRAPH 1
Existing home sales are stabilizing in Quebec, but remain very high from a historical perspective



Sources: Canadian Real Estate Association, JLR Land Title Solutions, Equifax Company and Desjardins, Economic Studies

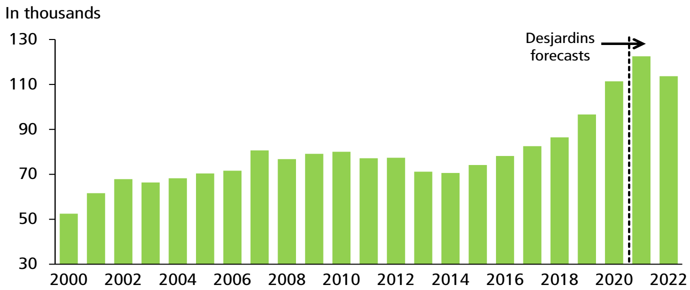
Last year, the spring lockdown prohibited in-person property viewings from March 23 to May 10, and few transactions were completed, except virtually. The statistics for January to April 2021 are, unsurprisingly, considerably higher than for the same period in 2020, a gain of around 40%![1] The comparison for April, even cumulative for the first four months of the year, is therefore not representative. This growth will gradually wane starting this summer, when sales will be compared against the exceptional post-spring 2020 lockdown levels.

Our forecast therefore calls for an 8.5% increase in sales through a real estate broker this year. This growth is much slower than in previous years due to the insufficient supply of properties. Sales will, however, reach a new peak this year with close to 125,000 real estate broker transactions. Although a decrease of between 5% and 10% is expected in 2022 for the reasons mentioned below, the number of sales will remain high from a historical perspective (graph 2 on page 2).

New construction is also losing some steam. Housing starts hit a record high in January at 112,061. This high level is due mainly to the acceleration of some work by builders fearing that a shutdown similar to the one a year earlier would again

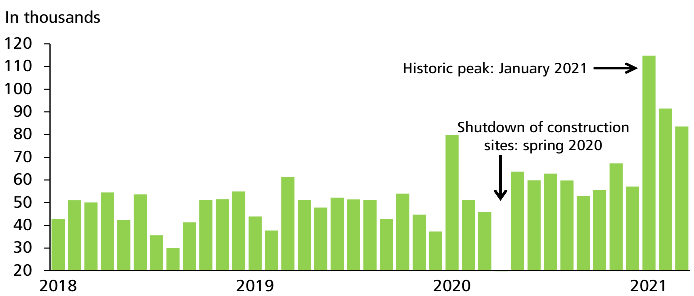
[1] A similar increase has been noted in sales through real estate brokers and in total sales (including sales by owner), which were 38.8% and 43.8% respectively for the first four months of 2021, compared to the same period a year earlier.

GRAPH 2
Existing home sales in Quebec will be lower next year, but close to 2021 record levels



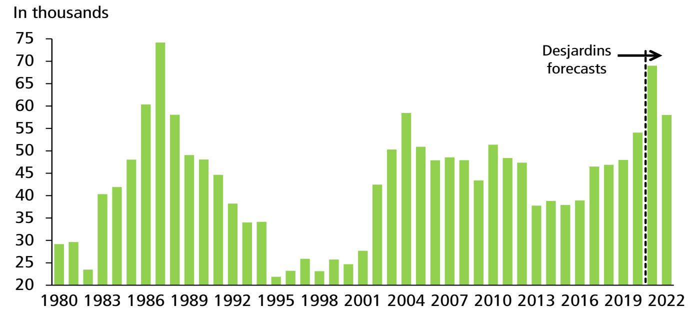
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 3
Residential housing starts have been slowing for the past few months in Quebec, moving further away from the January peak



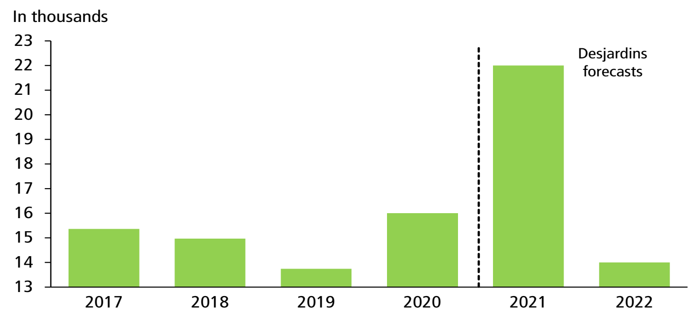
Sources: Canada Mortgage and Housing Corporation and Desjardins, Economic Studies

GRAPH 4
Housing starts in Quebec in 2021: close to the peak observed in the late 1980s



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

GRAPH 5
Housing starts for single-family homes will peak in Quebec this year and then slump in 2022



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

be imposed. In April, housing starts declined for a third straight month, but are still historically very high (graph 3).

A downward trend therefore appears to have begun, with a number of factors contributing to the decrease, namely soaring construction costs and land prices and ever-longer supplier deliveries due to high activity, which can discourage some buyers. A construction worker strike was avoided, that would have further weakened housing starts temporarily. The year 2021 will finish on a positive note.

Until now, housing starts have more than doubled compared to last year. The shutdown of construction sites from March 23 to April 10, 2020, weakened spring 2020 statistics and is making the comparison with 2021 shaky. Our forecast nevertheless calls for 69,000 new dwellings this year, an increase of more than 25% from last year. This will be the highest level since the peak of 74,000 units in 1987 (graph 4). Activity will slow down in 2022, since a post-pandemic pullback is expected, especially for single-family home construction (graph 5).

In summary, existing home sales and housing starts will slump in 2022, but activity will continue to be high from a historical perspective. Supply and demand will be influenced by various factors, which will also lead to weaker price growth.

Factors That Will Alleviate Demand:

- Purchasing a property has become much less affordable. The surge in prices and the already rising fixed mortgage rates have substantially increased purchase costs for buyers.
- New buyers will be subject to the new federal rule. The maximum loan amount granted by a financial institution will be based on the interest rate offered plus a prudence margin of 2% or 5.25%, whichever is higher. This measure will take effect on June 1 and will limit buyers' borrowing capacity.
- High prices: young households or first-time buyers are struggling to save a large enough down payment.
- The purchase price is sometimes significantly higher than the real property value and beyond a borrower's financial capability. This can jeopardize some transactions and limits the number of potential buyers overall.
- Construction costs are often higher than at the time of contract signature, prompting many developers to raise the

delivered price, sometimes with a substantial price difference. Exceptionally high material prices will cool potential buyers.

- Post-pandemic enthusiasm will be more subdued for houses and cottages: the gradual resumption of outings, recreational activities and eventually travel abroad will reduce the housing budget.

Consequently, the pool of buyers will be smaller and the number of existing home sales will be lower next year, moving away slightly from the record high hit in 2021. New construction will be under less pressure as well.

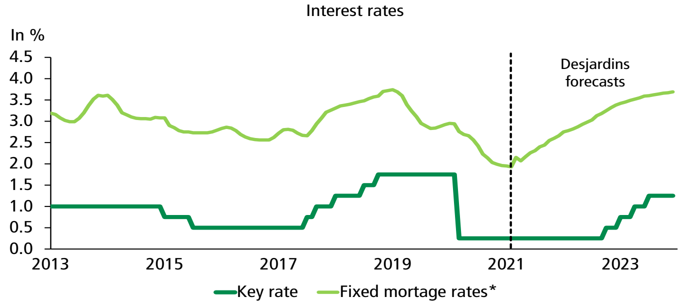
Factors That Will Increase the Supply of Properties for Sale:

- Owners reluctant to sell their single-family home during the pandemic might at last go ahead: some households will move into condos, conventional rentals or seniors' residences.
- Some recent buyers of principal residences or vacation properties will make travel and recreation one of their priorities again. More house or cottage listings will restore flexibility for those on a tighter budget.
- When the bidding war phenomenon begins to subside, some speculators who recently paid a disproportionate price hoping that the hot streak would continue might resell their property for fear that they will not recoup their investment later.
- The recent surge in single-family home construction, particularly in areas far from major centres, is increasing the number of available dwellings. In the event that major centres become more appealing again once the pandemic is over, the pool of properties for sale in small Quebec municipalities will grow.

Factors That Will Limit the Increase in the Supply of Properties for Sale:

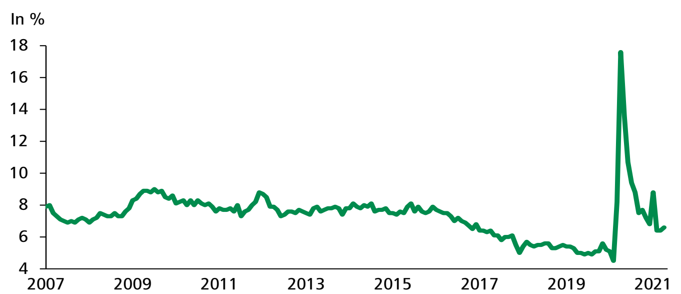
- For current properties, the rise in fixed mortgage rates will not affect monthly payments until loan renewal. The anticipated increase (graph 6) will not be enough to cause financial hardship or an avalanche of properties for sale.
- The gradual return to a low unemployment rate, which is already around 6.5% in Quebec (graph 7), is solidifying the situation for households, and few will have to put their property up for sale in this context.
- At the beginning of the pandemic in spring 2020, when the unemployment rate exceeded 15%, many households received debt repayment deferrals from financial institutions. Since the labour market has nearly fully recovered, most borrowers are able to make their monthly payments. Consequently, the number of properties for sale will not be inflated by a large number of households struggling to make ends meet.

GRAPH 6
Fixed mortgage rates will be higher even if the key rate will hold until the fall of 2022



* 5 years or more, weighted average interest rate on cash advances.
Sources: Bank of Canada and Desjardins, Economic Studies

GRAPH 7
The unemployment rate fell significantly after hitting a record high in Quebec



Sources: Statistics Canada and Desjardins, Economic Studies

All in all, given all the overlapping factors, the pool of properties for sale will increase moderately in the coming quarters. In our opinion, this will not be enough for a widespread decline in prices in Quebec. According to the Canada Mortgage and Housing Corporation, at the current sales level, the supply of properties for sale (current listings with real estate brokers) would have to be three times higher than it is now for balance to return to the market.

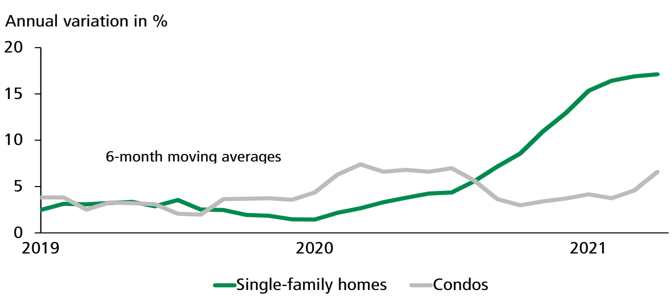
Effect on Prices

This does not suggest a significant market deterioration within a short period of time and reduces the risk of a surplus that would lead to a general decline in prices in the near term. In the past, a surplus situation drove prices down a few times. However, prices held up well in Quebec during the 2008–2009 recession because a major imbalance between supply and demand was avoided.

This time, the very widespread bidding war phenomenon on the Island of Montreal and in neighbouring areas is artificially inflating prices. In a recent report, the Bank of Canada pointed out high signs of price exuberance in some of the country's markets, particularly in Montreal, Ottawa and Toronto. When the market calms down somewhat and the gap between the asking price and the price offered by the buyer narrows, single-family home prices in Greater Montreal might drop. The pendulum will be merely swinging back in the hottest neighbourhoods for this type of housing. While this would not be enough to drive the average price down for all of Quebec, it would bring some stabilization next year.

In the Montreal metropolitan area, condos and plexes account for close to half of sales. These two segments, which are also very much in a seller's market, are less threatened by lower demand and higher supply in a post-pandemic context. On the contrary, there will be more buyers given that condos will be more affordable. The average price of this type of housing did not increase as fast as that of single-family homes since the start of the pandemic (graph 8). The eventual return to central neighbourhoods will encourage the purchase or rental of apartments and plexes. The gradual resumption of immigration, particularly international students, will stimulate mainly rental apartments in major urban centres, notably those near university campuses.

GRAPH 8
Single-family homes average price increased faster than condos in Quebec

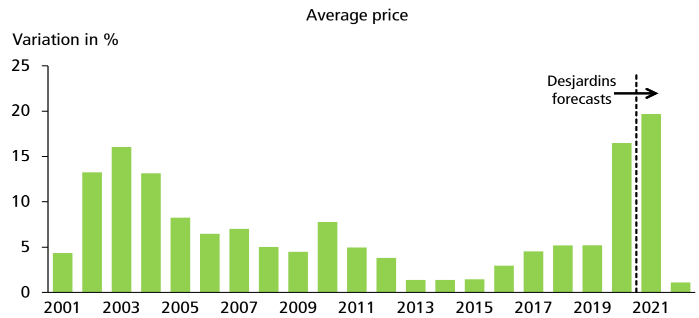


Sources : JLR Land Title Solutions, Equifax Company et Desjardins, Études économiques

In more remote areas, the surge in new construction since the beginning of the pandemic has pushed up the number of dwellings. If people return to major centres in droves once the pandemic is over, a surplus of homes in rural areas could lower prices in some locations.

To sum up, the potential correction in single-family home prices on the Island of Montreal and in neighbouring areas, as well as in some locations further away from major centres, will be probably insufficient to lower the average price for the entire Quebec market. For the time being, growth is continuing, but should slow in the second half of 2021. The average price of a property in Quebec is currently hovering around $450,000 (table). Prices are, however, expected to stabilize somewhat next year after the dizzying increase of about 20% this year and more than 15% in 2020 (graph 9).

GRAPH 9
The increase in the average price of properties in Quebec will give way to a lull next year



Sources: Canadian Real Estate Associations and Desjardins, Economic Studies

TABLE

Quebec housing market outlook 2021–2022

	2018	2019	2020	2021f	2022f
New housing market					
New construction ($B)	**12.0**	**11.7**	**12.7**	**17.0**	**14.0**
Annual variation (%)	16.1	-1.9	7.8	34.2	-17.6
Housing starts	**46,874**	**47,967**	**54,066**	**69,000**	**58,000**
Annual variation (%)	0.8	2.3	12.7	27.6	-15.9
House	**14,968**	**13,742**	**15,995**	**22,000**	**14,000**
Annual variation (%)	-2.6	-8.2	16.4	37.5	-36.4
Single-detached	***10,060***	***8,989***	***10,861***	---	---
Annual variation (%)	*-6.1*	*-10.6*	*20.8*	---	---
Semi-detached	***2,995***	***2,966***	***3,514***	---	---
Annual variation (%)	*6.2*	*-1.0*	*18.5*	---	---
Row housing unit	***1,913***	***1,787***	***1,620***	---	---
Annual variation (%)	*4.3*	*-6.6*	*-9.3*	---	---
Apartment	**31,906**	**34,225**	**38,071**	**47,000**	**44,000**
Annual variation (%)	2.5	7.3	11.2	23.5	-6.4
Condo [1]	***9,860***	***8,172***	***7,222***	***8,000***	***7,300***
Annual variation (%)	*-8.7*	*-17.1*	*-11.6*	*10.8*	*-8.8*
Rental [1]	***20,503***	***24,861***	***28,709***	***32,000***	***33,000***
Annual variation (%)	*6.5*	*21.3*	*15.5*	*11.5*	*3.1*
Conventional rental [2]	***16,752***	***21,536***	***26,554***	***29,500***	***30,200***
Annual variation (%)	*24.0*	*28.6*	*23.3*	*11.1*	*2.4*
Retirement home [2]	***3,565***	***3,159***	***2,017***	***2,500***	***2,800***
Annual variation (%)	*-35.4*	*-11.4*	*-36.2*	*23.9*	*12.0*
Resale market					
Unit sales	**86,451**	**96,636**	**112,971**	**122,533**	**113,657**
Annual variation (%)	4.7	11.8	16.9	8.5	-7.2
Weighted average price ($k)	**308**	**324**	**377**	**451**	**456**
Annual variation (%)	5.2	5.2	16.5	19.7	1.1
Sales volume ($B)	**26.3**	**30.5**	**42.6**	**55.3**	**51.8**
Annual variation (%)	9.1	15.8	39.7	29.8	-6.2
Other indicators					
Vacancy rate for rental units[3] (%)	**2.3**	**1.8**	**2.5**	**3.2**	**3.5**
Average rent[3] ($)	**761**	**800**	**844**	**865**	**890**
Annual variation (%)	3.4	5.1	5.5	2.5	2.9
Renovation spending[4] ($B)	**13.7**	**14.2**	**12.4**	**14.3**	**14.8**
Annual variation (%)	6.0	3.9	-13.0	15.6	3.5

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, Statistics Canada and Desjardins, Economic Studies