FORECAST SUMMARY

Gatineau

Canada Mortgage and Housing Corporation

# Bell has tolled for expansionary policy

Fall - Winter 2004

**Central banks' expansionary cycle comes to an end and oil price rises**

The U.S. engine has just started going full tilt again, and there is already a little sand in the gears, which is pointing to an economic slowdown in 2005. The year 2004 marked the awakening of the U.S. giant in the employment sector. After three consecutive years of negative results, the labour market has posted gains of some 170,000 jobs per month since the beginning of 2004.

As well, after two quarters, the annual rate of economic growth was close to 4 per cent. However, inflation is rising faster than expected, such that the monetary tightening cycle is already under way. What's more, certain fiscal stimuli will disappear in 2005, the rise in oil prices is causing some concern, and many experts are anticipating that the real estate market will cool down. This last factor, combined with the rate hike, could discourage households from using mortgage credit to finance their consumer expenditures, as they had massively done in recent years.

Fortunately, at the global level, growth is accelerating in the major economic blocs. The United States is no longer the only driving force behind global growth. We can now count on the very fast pace of development of China and India, for example.

In Canada, certain factors are giving the Bank of Canada more latitude, such that it does not need to promptly follow the Fed. In fact, the lower inflation here, the economy operating below capacity and a very strong Canadian dollar brings certain small differences to our national policy. However, the expansionary period is now over here, as well. In fact, with the economy running nearly at full capacity, it would be appropriate to tone down monetary easing in order prevent an intensification of inflationary pressures. In this context, it is highly probable that the Bank of Canada will continue to opt for a progressive rise in interest rates.

CMHC forecasts that one-year mortgage rates will go up by about 1 percentage point from now until the fourth quarter of 2005. The impact will be slightly lesser on medium-term rates. In fact, for a five-year term, Canadians will be able to get a mortgage at around 7.15 per cent at the end of 2005, for an increase of about three quarters of a percentage point over the current rate. The rate hike will therefore be relatively modest, which is good news for the real estate market.

## IN THIS ISSUE



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### Real estate market to slow down gradually in 2005

With Canadian economic growth now close to full capacity, an eventual slowdown will come with a lull on the housing market.

Even if the high level of employment will very likely generate new demand, the real estate sector could not go any higher than the current plateau. However, the slowdown will be minimal in 2005 and may eventually intensify by 2007. On the resale market, it is therefore expected that 4,300 homes will change hands in 2005 (4,800 in 2004), still a very honourable level. On the new home market, housing starts will stay at around 2,750 units.

### Resale market loses some speed

While 2003 was already quite a record year for the resale market, the results for 2004 are holding their own. At mid-October, the number of transactions on the market was slightly above last year's level, and there is every indication that 2004 will be much like 2003. It should be noted here that the new rise in listings was a determining factor this year. From a year-over-year gain of 10 per cent last December, their current level is 6,504 units, or 16 per cent more than in October 2003.

#### *More choice for buyers*

The existing home market is therefore giving more latitude to consumers this year. Even if the massive arrival of new listings could have drowned out sales, this was not the case. On the contrary, this new supply met a latent demand that had been frustrated by the lack of homes on the market. The high level of transactions was consequently the direct result of this influx of listings, but this effect should wane over the coming months. In fact, since September, certain early signs have become apparent. In fact, the seller-to-buyer ratio, which had stayed low even with the increase in supply, has slowly started to rise again since August.

#### *Mortgage rate hike should slow down price increases*

While the new listings were good for the market, the recent and anticipated mortgage rate hikes will have the opposite effect. Since the end of 2003, the progressive rise in supply has breathed new life into the market. This effect should wane over time, however, as it will now be combined with the increase in mortgage rates, which will slow down demand. In fact, these two factors combined have started to have an impact on the seller-to-buyer ratio, which began rising again in August for the first time since the end of 2003. As a result, this ratio has just risen above 5 to 1, while it had been staying close to 4.5 to 1. Despite these small increases, we are still faced with a market where sellers continue to maintain their edge. This advantage will not be sufficient, however, to lead to price rises such as those recorded in the last 12 months. Rather than two-digit increases, we believe that the hikes will now be below 10 per cent and that the average price of dwellings (houses and condominiums) will not exceed the $155,000 mark from now until the end of 2005.

### Household formation significantly limits residential construction

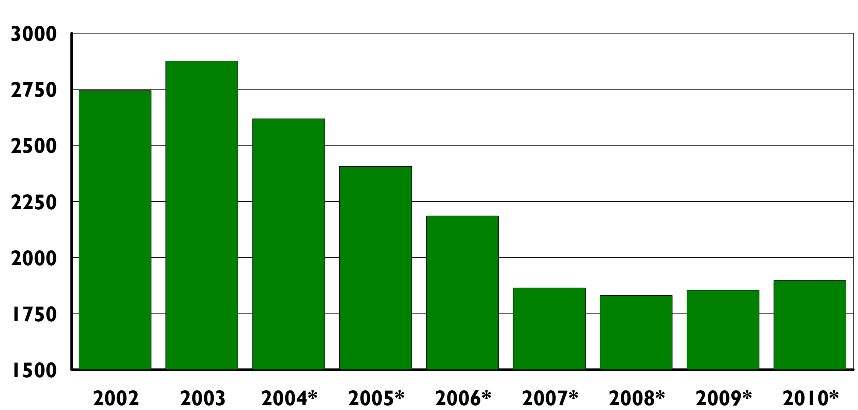
Along with the Montérégie, Laval, Lanaudière and the Laurentians, the Outaouais region is one of the sectors where demographic growth will be greater than the provincial average. With the natural rise in the population curbed by the low birth rate, only migration flows will be responsible for the positive demographic changes. The Outaouais area is heavily favoured by provincial immigration and, to a lesser extent, interregional migration. International immigrants, for their part, are not very numerous. However, even if this area has the edge over the others in terms of demographic growth, the population will increase at a slower rate than in recent years. In fact, after reaching a peak in 2003, household formation should now slow down over the coming years. Such a trend would toll the bell for the feverish construction of the last few years. In fact, even if housing starts do not rigorously follow household formation, this variable is still its essence. While household formation may not provide an accurate forecast of new constructions, it at least indicates the trend. For example, it should be noted that, in 2003, the correlation was almost perfect, as household formation reached a level of 2,876 and starts attained 2,801 units. One of the ways, if not the only way, to counter the upcoming decline in starts would be to raise migrations flows. But is this a feasible challenge?

### New rise in listings curbs single-family home building

The presence of a greater number of homes for sale will not just impact the resale market. In fact, this new supply is favouring not only potential buyers of existing homes, but all possible home seekers. With this supply getting scarcer, even natural clients of the resale market, such as first-time buyers, turned to the new home market. This rise in demand for new homes, combined with the increase in construction costs, did not take long to have an impact on prices.

As a result, while the almost total lack of supply was maintaining the increase in prices on the resale market at a quarterly

**Net Household Formation**




***Source: ISQ projections**

rate of 15 per cent, prices on the new home market were relatively stable in 2002 and 2003. Dissatisfied with the lack of choice, consumers then flocked to the new home market, which would partly explain the soaring prices. Consequently, from 5 per cent for the first half of 2003, the price increase reached a quarterly rate of 20 per cent as of the second half of last year. Even with the continued low mortgage rates, these price hikes put homeownership out of reach for many households.

For these households who were unable to go ahead with their home buying decision, the new rise in listings is good news. Not that this influx of properties can cause prices to drop but, in the medium term, it can at least stabilize them. This will then allow for a distinction between new and existing homes. In fact, despite the significant price variations observed in recent months, new homes cost, on average, $10,000 more than existing homes. This is an attractive difference if buyers have the choice. The arrival of a greater number of new listings could therefore lead to an exodus of buyers toward the resale market and, as a result, drive down demand for new homes. This, along with the decrease in household formation, was the basis for our forecast of fewer than 2,800 starts for each of the next two years.

**Condominium construction: new Eldorado of the new home market?**

Another effect of the general upsurge in prices was the success of condominiums. The last attempt to introduce this housing type in the Outaouais dates back more than 10 years and was not exactly successful. In fact, many of these constructions that were intended to be condominiums wound up as rental housing instead, due to lack of demand. Today, the situation is quite different. First of all, even if the new city of Gatineau is not as extensive as the Montréal or Toronto metropolitan areas, it is increasingly establishing itself as a veritable urban centre. And, the primary feature of condominiums is that they are essentially an urban housing type, a dwelling downtown, where land is starting to become scarce.

However, land in the Outaouais is not yet as scarce or expensive as in other metropolitan areas. By banking on this factor and the wish of some households to become homeowners, certain builders have discovered a real gold mine in condominiums. These builders are effectively managing to provide these potential buyers, hurt by unaffordability, with dwellings that are similar in almost every respect to the apartments that they are leaving, but that belong to them. The question that remains, however, is knowing how many of these dwellings the market can absorb. As long as young households with good jobs will want to access homeownership, condominiums will remain an interesting solution. But, it should not be forgotten that, with the rise in construction costs, especially for multiple housing projects, the price of condominiums will also go up, which will once again exclude some buyers. Caution therefore remains a must on this market, which no one would want to see become part of the rental housing segment, on account of a surplus supply. With 650 starts in 2004, the supply of this type of housing will reach a peak, and activity will then slow down slightly in 2005.

**Rental market to ease slightly**

Although, in 2003, the volume of rental housing construction had not managed to ease market conditions, activity in this segment was less vigorous this year. In fact, we are forecasting that 2004 will end with just 500 apartment starts, for a decrease of 30 per cent. In spite of this reduction in the supply of new units, the market should be less tight over the next two years.

The main reason why market conditions will ease is the strong homeownership trend that has been prevailing for the last two years. In fact, many of the numerous buyers in 2003 vacated their apartments only in 2004, and the same thing will happen again this year. Access to homeownership therefore has a delayed effect on the availability of rental dwellings and, given that this trend was particularly strong in 2004, even more apartments will become vacant in 2005. However, the vacancy rate will stay under the 3-per-cent mark until 2005, with supply being less significant.

A greater availability of units will curb the increase in rents. This is all more true in that many households, as noted earlier, prefer to pay the equivalent of a high rent in monthly mortgage payments for a condominium. The rate hike on the rental market will consequently be below 4 per cent.

## FORECAST SUMMARY
## Gatineau Census Metropolitan Area (CMA)
### Fall - Winter 2004

| | 2002 | 2003 | 2004f | 2005f | 2003/2004 | 2004/2005 |
|---|---|---|---|---|---|---|
| **RESALE MARKET** | | | | | | |
| **Active MLS® listings** | 1,532 | 1,535 | 2,600 | 3,000 | 70% | 15% |
| **MLS® sales** | | | | | | |
| Total | 4,524 | 4,597 | 4,800 | 4,300 | 4% | -10% |
| Single-family | N/A | N/A | N/A | N/A | N/A | N/A |
| Condominium | 249 | 352 | 325 | 300 | -7% | -8% |
| **Average MLS® price ($)** | | | | | | |
| Single-family | N/A | N/A | N/A | N/A | N/A | N/A |
| Condominium | 89,000 | 104,000 | 112,000 | 115,000 | 8% | 3% |
| Overall | 113,000 | 130,000 | 150,000 | 155,000 | 15% | 3% |
| **NEW HOME MARKET** | | | | | | |
| **Housing starts** | | | | | | |
| Total | 2,553 | 2,801 | 2,750 | 2,450 | -2% | -11% |
| Freehold | 1,929 | 1,885 | 1,600 | 1,500 | -15% | -6% |
| Condominium | 30 | 209 | 650 | 550 | 211% | -15% |
| Rental | 594 | 707 | 500 | 400 | -30% | -20% |
| **Average prices ($)** | | | | | | |
| Detached | 146,163 | 177,491 | 190,000 | 196,000 | 7% | 3% |
| Semi-detached | 93,157 | 118,952 | 125,000 | 130,000 | 5% | 4% |
| **RENTAL MARKET** | | | | | | |
| Vacancy rate (%) | 0.5 | 1.2 | 1.9 | 2.3 | --- | --- |
| Change in rents from previous year (%) | 4.0 | 7.0 | 5.0 | 3.0 | --- | --- |
| **ECONOMIC OVERVIEW** | | | | | | |
| Mortgage rate - 3-year (%) | 6.30 | 5.82 | 5.69 | 6.45 | --- | --- |
| Mortgage rate - 5-year (%) | 7.00 | 6.39 | 6.28 | 6.95 | --- | --- |
| Change in employment from previous year | 1,925 | 1,925 | 4,500 | --- | --- | --- |
| Unemployment rate (%) | 6.9 | 6.9 | 6.8 | 7.0 | --- | --- |

*f: Forecast*

*N/A: Not available*