HOUSING MARKET OUTLOOK

Montréal

Canada Mortgage and Housing Corporation

www.cmhc.ca

SPRING 2006

Heading for a soft landing

IN THIS ISSUE

Introduction

Fewer starts, more existing properties for sale and significantly smaller price increases, in short, the housing market showed its first signs of weakening, after three years of frantic growth. This year and next year, the residential real estate market will continue to post a solid performance, but certain factors, such as the rise in mortgage rates, are pointing to a slowdown in a number of indicators. In the following pages, CMHC's experts will give their views on the housing market trends for 2006 and 2007.

Economic context

Our neighbours to the south still showing a good rate of growth

The U.S. economy posted a good performance in 2005. Real GDP growth reached 3.5 per cent, which is slightly above its capacity. The economic climate remained healthy south of the border, and observers anticipate a growth rate of more than 3 per cent this year. For 2007, the U.S. economy should grow at a slower pace. The most optimistic forecasters are banking on a growth rate of 3.2 per cent.
Also, after a number of good years, for both housing starts and resale volumes, as well as the spectacular growth in prices, the U.S. real estate market has now been recording declining figures for some time. For the moment, these signals suggest that this market is in for a soft landing, rather than a crash as others are predicting. However, there should be a decrease in refinancings, which will have a downward impact on household consumer spending.

Canadian economy: major differences between the provinces

The Canadian economy grew at a rate of approximately 2.9 per cent in 2005. The rise in domestic demand largely accounted for this result. Strong demand for oil, along with the increase in the price of this product, stimulated growth in Alberta. The rate of growth was also very steady in British Columbia.

Unfortunately, the same cannot be said about the economies of the provinces further east, including Ontario and Quebec. These two provinces are more dependent on the manufacturing sector, which is being severely tested by the competition from several countries with abundant cheap labour. And, of course, there is also the Canadian dollar that is continuing to soar against the U.S. dollar, which is reducing the competitiveness of our exports.

In fact, Quebec's real GDP rose by just 2 per cent approximately in 2005. The trade deficit and the decline in residential investments explain why economic growth was weaker in Quebec than in Canada overall.

In the case of Montréal, the Conference Board of Canada estimated real GDP growth at 1.8 per cent last year, which is less than in most major urban centres across Canada. Residential construction declined by 12 per cent in this city.

We expect that Canada's real GDP will grow at a rate of 3.1 per cent in 2006. Like in 2005, the growth should be strong in the West, but generally more moderate in the eastern provinces.

Still for the current year, we forecast that Quebec's real GDP growth will reach 2.3 per cent. The Canadian dollar, which should stay at historically high levels relative to the U.S. currency throughout the year, and the anticipated weak job creation will cause the Quebec economy to perform at a lower level than the Canadian economy.

For Montréal, the Conference Board of Canada forecasts that GDP growth will be in the order of 2.6 per cent in 2006, on account of the construction of two major university hospital projects, which should get under way by the end of the year. For our part, we are slightly less optimistic, and we forecast that employment in Montréal will grow by 0.8 per cent (15,000 jobs) this year and by 0.7 per cent (13,000 jobs) in 2007.

In 2007, real GDP growth should stay at about the same level as this year for Canada (3.0 per cent), but rise to 2.6 per cent for Quebec. As for the Montréal metropolitan area, the performance would of course be similar to the province's level.

Rise in interest rates coming to an end

As for monetary policy, we forecast that the Bank of Canada will continue to adopt a more restrictive stance and therefore raise the overnight rate target. But, there is every indication that this monetary tightening is coming to an end.

Since short-term mortgage rates affect medium-term and long-term rates, we anticipate that, by the end of 2006, one-year and five-year mortgage rates will reach 6.5 per cent and 7.0 per cent, respectively, for increases of 25 basis points over the current rates, in both cases.

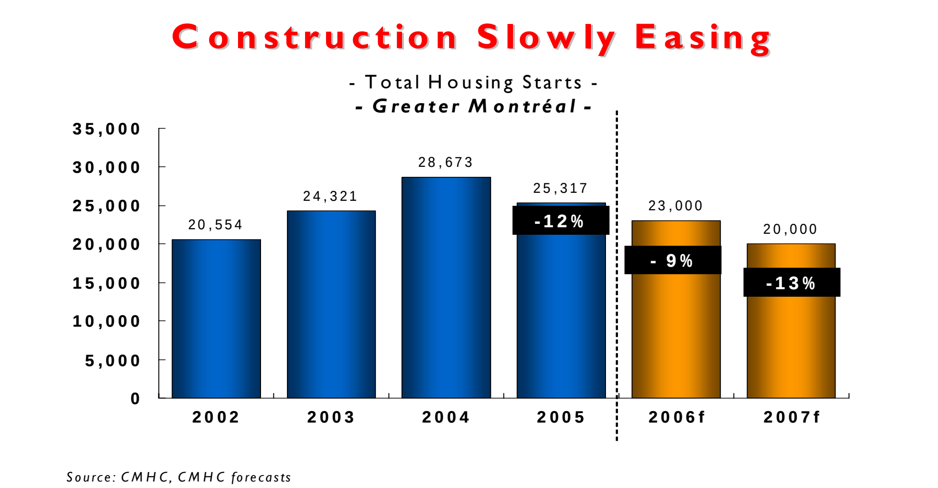
For 2007, we are forecasting a very slight decrease in the one-year mortgage rate, which should therefore end the year at 6.4 per cent. The five-year rate, for its part, will remain at about 7.0 per cent.

New home market

New job sites to decrease slightly

The numerous cranes that have been towering over the Montréal landscape in recent years will not be disappearing any time soon, but their numbers will gradually decline. In 2004, the Montréal metropolitan area posted its best performance in 16 years, and several factors suggest that this was the peak of the residential construction cycle. In 2005, housing starts effectively registered a first decrease (-12 per cent) in seven years. Only the rental segment posted a gain (+4 per cent). The same trends are emerging for this year, and we are anticipating another decrease in activity, in the order of 9 per cent this time, which should result in some 23,000 starts in the Montréal metropolitan area (see Figure 1). Once again, the rental housing segment could escape the downward trend this year

Figure 1



and maintain practically the same construction volume. But, for 2007, we believe that this segment will be affected by the slowdown, as well, such that the decrease in the number of new dwellings will be generalized across all segments, and starts will fall by 13 per cent overall, to 20,000 units. Let's take a closer look at what this could mean for each market segment.

Freehold homes set the tone

It is in the freehold (single-family) home segment that supply most rapidly adjusts to demand, first, since there is practically no speculative construction in this market and, second, because it takes much less time to plan and complete homes of this type than concrete high-rise buildings. In fact, houses are usually all built on demand, once the sale has been closed with the buyer. Now, the downward trend in starts in this segment began in the fall of 2004. It seems well under way and therefore quite predictable. The economic factors mentioned earlier, especially the rise in mortgage rates, will continue to curb activity somewhat in this market segment. We forecast that foundations will be laid for 8,500 freehold homes this year, or 14 per cent fewer than in 2005. There should be an equivalent decrease next year (-12 per cent), when 7,500 starts are expected. At that time, we will fall back below the average levels for the 1990s.

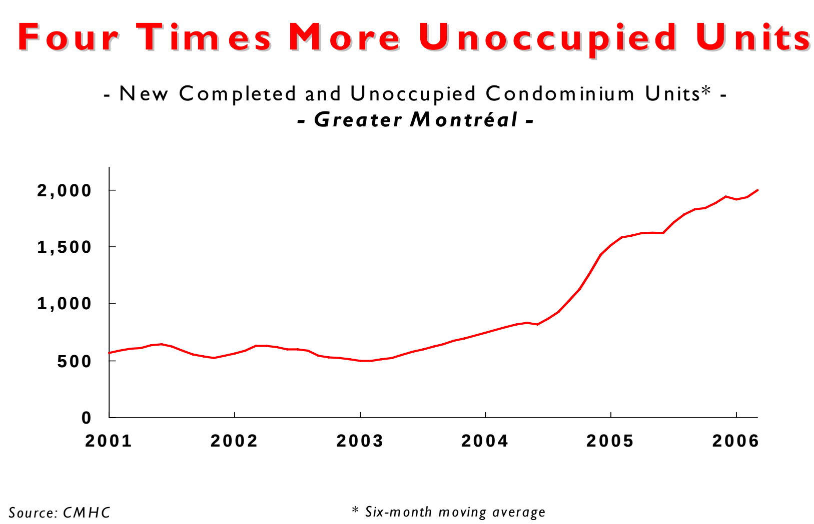
Condominiums to lose their momentum

The year 2004 was also a record year for condominium construction in the Montréal metropolitan area. More than 10,000 such units were started that year, or almost as many as single-detached homes. Of course, this was an all-time record for this housing type, which is constantly eating away at the market shares of the other segments. For example, in 1990, condominiums accounted for only 13 per cent of all starts. By last year, this proportion had reached 35 per cent. While, from a structural standpoint, the prospects are good for condominiums, particularly on account of the aging population, smaller households and scarce urban lands, from a purely conjunctural standpoint, condominium construction is bound to slow down over the coming months. Demand has remained strong, but the increase in newly completed and unoccupied units (see Figure 2) clearly shows that, at the same time, supply has risen more rapidly, which has also meant longer absorption periods for most new projects.

As a result, a slowdown in construction is expected, even necessary, in order not to further accelerate the growth in inventories of unsold condominiums. It should also be taken into account that existing condominiums for sale are rising rapidly (see the section on the resale market). Supply is therefore growing on both the new and existing condominium markets. It would be expected that builders would slow down the pace in the short term, to avoid creating surpluses and causing an imbalance in this market. However, supply appears to be slow in adjusting to this new reality. At the end of the first three months of 2006, condominium starts were on the rise. We maintain that they should decrease very soon, although the surprising performance in the first quarter has forced us to revise our forecasts upwards for this segment. In all, 8,000 condominiums should be started this year, down by 9 per cent, while 7,000 new units should get under way next year, for a decrease of 13 per cent.

Finally, given that new condominiums may be somewhat more difficult to sell over the coming months and that competition will be fierce, it would be normal for developers to position their new projects in relatively affordable price ranges. The upscale segment tends to be generally more vulnerable when turnarounds occur, which is precisely what is happening right now.

Figure 2



Condominiums downtown: moderation would be in good taste

Despite the significant rise in newly completed but still unsold condominiums, we do not consider that the time required to absorb these units is overly alarming in most sectors, with the notable exception of downtown. In March, there were only 225 completed and unoccupied condominiums in downtown Montréal, a figure that is no cause for concern in itself. Where the problem lies, however, is in the fact that close to 2,200 more were under construction, not to mention a few hundred additional units in buildings that are being recycled, which are not accounted for in our starts survey for the moment. Since 730 units were absorbed downtown in 2005, the volume of condominiums that will soon arrive on the market appears disproportionate in relation to the strength of the demand. We feel that it will take at least two years to absorb all these units if no other projects are added in the meantime. But, more projects are now being announced. It would therefore be important for developers to exercise caution, particularly for any new projects that would target the luxury condominium niche, which is currently saturated downtown. Now, more than ever, projects will need to have very solid financing packages so that developers may get through this adjustment period.

Rental housing construction: retirement home projects abound

The volume of rental housing construction should stay very close to the level registered in 2005, which was in fact the best year since 1989 in this segment. The tremendous enthusiasm of developers for seniors' apartments will definitely be the factor that will make this result possible. According to our projections, construction will get under way on 6,500 rental housing units (-3 per cent) this year. Next year, however, starts will likely fall to around 5,500 units, for a decrease of 15 per cent.

We surveyed the intentions of key retirement home developers in the Montréal area, and there could be up to 3,500 units started in this market niche as of this year. Most of these new units would be part of large, relatively luxurious apartment buildings for independent clients. Laval and, to a lesser extent, Brossard are the top sectors targeted by retirement home developers. Specifically in Laval, where there are already 720 units under construction, the numerous projects announced for the coming months, which represent some 1,800 units, will surely lead to a significant rise in the vacancy rate. If all these projects are built, the Laval market will be headed straight for a surplus of rental housing units for seniors in 2007.

The construction of traditional rental buildings, for its part, will be modest. The high construction costs are greatly affecting the profitability of new housing projects. In the case of concrete structures, developers must generally charge monthly rents exceeding $1,000 per unit to make such constructions profitable. They then have difficulty in competing with homeowner monthly payments.

Affordable, social and cooperative housing starts will complete the picture. The construction of such housing projects, made possible thanks to the various programs offered by the different levels of government, is not over. However, it is practically impossible to make any forecast in this regard.

Resale market

Transactions still near their record level

Against all expectations, the Montréal metropolitan area resale market ended 2005 on an extremely high note, which, in the end, allowed S.I.A.®/MLS® transactions to surpass the previous record set in 2002. The level to beat is now 37,951 sales1. The decline in consumer confidence and the new rise in mortgage rates will probably have little impact on the number of transactions that will be closed in the short term. This is because, on the other hand, the increase in listings (see Figure 3) will speed up the pace of transactions. We believe that resale activity will remain at around 37,500 transactions (-1 per cent) in 2006 and then decrease slightly in 2007 (-3 per cent to 36,500 sales). Slowly but surely, the pool of first-time home buyers will become slightly more limited as a result of the higher interest rates.

Listings to keep rising

The rise in listings that began almost three years ago is not about to slow down. Last year, properties for sale went up by 21 per cent for single-family houses, by 46 per cent for condominiums and by 11 per cent for plexes with two to five units. The increase was therefore much greater in the case of condominiums. In fact, condominium listings on the resale market are almost three times as numerous (+180 per cent) as they were in 2002, when they reached a cyclical low point. All this has been putting upward pressure on the listings-to-sales ratio. Overall, the market has remained favourable to sellers but, in certain sectors, the condominium segment has become balanced again.

Sellers will have to adjust progressively

Buyers are therefore progressively regaining some negotiating power. This particularly holds true for condominiums on the Island of Montréal. Consequently, the rate of increase in prices is clearly slowing down. Contrary to the annual price growth rates above 10 per cent observed over the period from 2002 to 2004, average prices rose instead by 7 per cent and 6 per cent, respectively, for single-family houses and condominiums, in 2005. So, the price fever has broken. Sellers who are asking for the moon are finding this out at their expense. Listing periods are getting longer, and multiple offers are getting scarcer. "Reduced Price" signs are even starting to re-appear in certain sectors, something that had not been seen for quite some time. While still not very apparent in most suburban sectors, this new reality is being increasingly felt on the Island of Montréal, particularly in the West Island.

The price increases will be much smaller this year and next year. In the overall Montréal metropolitan area, the average price of single-family houses should be around $232,000 in 2006, up by 4 per cent, and $240,000 in 2007, for a gain of just 3 per cent. On the condominium market, which should become balanced as of this year, the growth in the average price will be weaker still and will not even surpass inflation. We believe that, in the Montréal metropolitan area, the average price of condominiums will reach $196,000 this year and $198,000 next year, for increases of just 2 per cent and 1 per cent, respectively. The plex market, which remains tight, will fare better. For this housing type, we are anticipating price hikes in the order of 6 per cent in 2006 and 4 per cent in 2007.

Rental market

Vacancy rate to reach 3 per cent in 2007

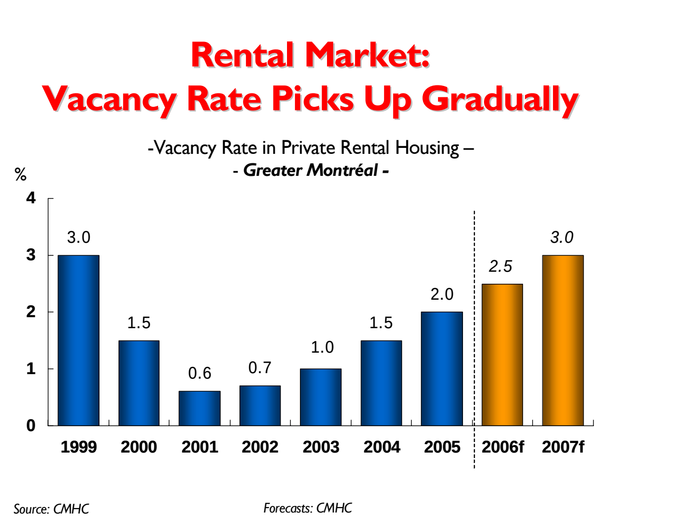
The vacancy rate rose slightly in the Montréal metropolitan in 2005, reaching 2 per cent. The rental market eased not only as a result of a weaker demand, mainly due to the shift to homeownership of many renters, but also because of a stronger supply of rental housing units following the construction of many projects in recent years. This was the fourth consecutive increase in the vacancy rate since the low point of 0.6 per cent recorded in 2001.

The factors that contributed to the gradual rise in the vacancy rate will still be present in 2006. The rental housing vacancy rate should therefore go up again and reach 2.5 per cent in 2006 and 3.0 per cent in 2007 (see Figure 4).

Favourable financing conditions will again incite numerous renter households to buy a home. In many cases, these households will opt for a condominium, a housing type that is in direct competition with upscale rental housing. The move to homeownership of these renters will vacate some dwellings, especially in the higher rent ranges. In 2006, however, this homeownership trend will be somewhat slowed by the new rise in mortgage rates and the significant increase in prices on the resale market in recent years.
Once again, demand for rental housing on the part of young people will not be very strong. In fact, following a loss of 3,400 jobs for people aged from 15 to 24 years in 2005, total employment growth (for all age

Figure 3

Figure 4



groups) will be only 0.8 per cent in 2006. There is consequently no indication of high employment growth for young people. On the other hand, rental housing demand will be supported by international immigration.

As for supply, the construction of 6,500 rental housing in 2006 and 5,500 more in 2007 will also contribute to easing the market. It should be mentioned, however, that most of these units will be intended for seniors and that there will be few new traditional rental dwellings.

With the market continuing to ease, landlords will have less room to raise rents. The average rent will rise by slightly more than the inflation rate, with increases of around 3.0 per cent in 2006 and 2.5 per cent in 2007.

In sum, the move to homeownership of many renter households, the construction of rental housing and the weak job market for young people are all factors that will work toward easing the market. International migration, for its part, will remain a significant variable in the new rental housing demand but will not manage to fully offset the effects of the other factors.The vacancy rate will therefore continue to rise gradually in 2006 and 2007.

(Footnotes)

1 Please note that we adjusted all resale market indicators to reflect the addition of certain municipalities to the Montréal metropolitan area.

Existing Single-Family Home Market

Level of % Change, 2005 to 2006 and 2006 to 2007 by Submarket

	Sales			Average Price ($)		
Submarket	**2005**	***2006p***	***2007p***	**2005**	***2006p***	***2007p***
Island of Montréal	**5,332**	***5,200***	***5,000***	**315,358**	***318,000***	***320,000***
Change from previous year	**-3%**	***-3%***	***-4%***	**4%**	***1%***	***1%***
Laval and North-Shore	10,521	*10,200*	*10,000*	187,045	*194,500*	*200,000*
Change from previous year	2%	*-3%*	*-2%*	9%	*4%*	*3%*
South-Shore	**6,686**	***6,600***	***6,500***	**203,487**	***214,000***	***222,000***
Change from previous year	**-1%**	***-1%***	***-2%***	**10%**	***5%***	***4%***
Total Montréal Area*	23,801	*23,200*	*22,500*	222,915	*232,000*	*240,000*
Change from previous year	0%	*-3%*	*-3%*	7%	*4%*	*3%*

**The sum of the submarkets does not correspond to the metropolitan area on account of the MRC of Vaudreuil-Soulanges.*
Source: CMHC, GMREB

New Single-family Home Market

Level of % Change, 2005 to 2006 and 2006 to 2007, by Submarket

	Starts					Average Price / Detached				
Submarket	**2005**	***2006p***	***Chg.***	***2007p***	***Chg.***	**2005**	***2006p***	***Chg.***	***2007p***	***Chg.***
Island of Montréal	**604**	***550***	***-9 %***	***500***	***-9 %***	**483,918**	***527,000***	***9 %***	***568,000***	***8 %***
Laval and North-Shore	5,860	*5,100*	*-13 %*	*4,500*	*-13 %*	267,260	*296,500*	*11 %*	*320,000*	*8 %*
South-Shore	**2,420**	***2,000***	***-17 %***	***1,800***	***-10 %***	**245,991**	***270,000***	***10 %***	***290,000***	***7 %***
Total Montréal Area*	9,872	*8,500*	*-14 %*	*7,500*	*-12 %*	276,017	*305,000*	*11 %*	*328,000*	*8 %*

** The sum of the submarkets does not correspond to the metropolitan area on account of the MRC of Vaudreuil-Soulanges.*
Source: CMHC

Forecast Summary

Montréal Metropolitan Area

May 2006

	2004	2005	2006*	2007*	Chg. (%) 2006 vs 2005	Chg. (%) 2007 vs 2006
RESALE MARKET						
MLS Sales (1)						
Single-family houses	23,846	23,801	***23,200***	***22,500***	**-3%**	**-3%**
Condominiums	7,991	8,912	***9,500***	***9,500***	**7%**	**0%**
Plexes (2 to 5 units)	5,576	5,238	***4,800***	***4,500***	**-8%**	**-6%**
Total	37,413	37,951	***37,500***	***36,500***	**-1%**	**-3%**
Active MLS listings						
Single-family houses	9,434	11,454	***13,500***	***16,500***	**18%**	**22%**
Condominiums	3,690	5,400	***7,200***	***9,700***	**33%**	**35%**
Plexes (2 to 5 units)	2,347	2,603	***2,800***	***3,300***	**8%**	**18%**
Total	15,470	19,458	***23,500***	***29,500***	**21%**	**26%**
Average MLS price						
Single-family houses	207,908	222,915	***232,000***	***240,000***	**4%**	**3%**
Condominiums	181,571	191,623	***196,000***	***198,000***	**2%**	**1%**
Plexes (2 to 5 units)	262,904	289,512	***307,000***	***318,000***	**6%**	**4%**
NEW HOME MARKET						
Housing Starts						
Single-family houses	12,177	9,871	***8,500***	***7,500***	**-14%**	**-12%**
Condominiums	10,053	8,758	***8,000***	***7,000***	**-9%**	**-13%**
Rental housing units	6,443	6,687	***6,500***	***5,500***	**-3%**	**-15%**
Total	28,673	25,317	***23,000***	***20,000***	**-9%**	**-13%**
Average new house price						
Detached houses ($)	251,365	276,017	***305,000***	***328,000***	**11%**	**8%**
Semi-detached houses ($)	188,786	199,829	***215,000***	***228,000***	**8%**	**6%**
RENTAL MARKET						
Vacancy rate (October) (%)	1.5	2.0	***2.5***	***3.0***	**0.5**	**0.5**
Change in rents (%)	3.3	3.7	***3.0***	***2.5***	**--**	**–**
ECONOMIC OVERVIEW						
Mortgage rate 1-year (%)	4.6	5.1	***6.3***	***6.4***	**1.2%**	**0.1%**
Mortgage rate 5-year (%)	6.2	6.0	***6.8***	***6.9***	**0.8%**	**0.1%**
Employment (in thousand)	1,806	1,822	***1,837***	***1,850***	**0.8%**	**0.7%**
Annual employment variation (in thousands	19	16	***15***	***13***	**--**	**–**
Unemployment rate (%)	8.6	8.7	***9.0***	***9.2***	**--**	**–**

1 The publication of MLS data is made possible thanks to the cooperation of the Greater Montréal real estate Board.
** CMHC Forecast*
Sources: CMHC, GMREB and Statistic Canada

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