HOUSING MARKET OUTLOOK

Montréal

Canada Mortgage and Housing Corporation
www.cmhc.ca

FALL 2006

Economic section

U.S. economy: all eyes on the real estate sector

Since the beginning of 2006, the housing market, one of the pillars of the U.S. economy, has been shaky. For example, in August, transactions on the resale market decreased by 13 per cent and housing starts fell by 20 per cent in relation to August 2005. But the figure that drew the attention of many observers was the median price of existing homes, which went down by 1.7 per cent nationally, again for August.

Given these statistics, it is important to know that most fundamental indicators of the U.S. economy remain favourable, in particular, consumption, which has resisted until now. The U.S. gross domestic product (GDP) grew by 2.6 per cent in the second quarter, the economy continues to create jobs, the unemployment rate is holding at just 4.6 per cent and the period of monetary tightening is over. So far, then, things look worse than they really are, but we will of course have to wait before making a definite diagnosis.

Good news for the interest rates

At home, the same economic conditions prevail, that is, the Bank of Canada seems to want to stop raising the key policy rate (the increase has been 175 basis points since September 2005), and we believe that the Bank could even lower this rate in 2007. Medium-term interest rates, for their part, have already started to fall slightly. For example, this is the case for the five-year mortgage rate. It is anticipated that this rate will remain low over the next two or three quarters (as a result of the combined effect of the economic slowdown, the strength of the Canadian dollar against the U.S. currency and low inflation), during which period it should fall by 25 to 75 basis points before starting to rise again. In the fourth quarter of 2006 and in 2007, the posted rate for five-year mortgages should be in the 6.00 per cent to 7.00 per cent range.

This is therefore good news for the real estate market, as the significant increases in property prices in recent years have been gradually affecting affordability. In the short term, the rate hikes now seem to be behind us and will consequently not exacerbate the situation.

Montréal growth below the Canadian average

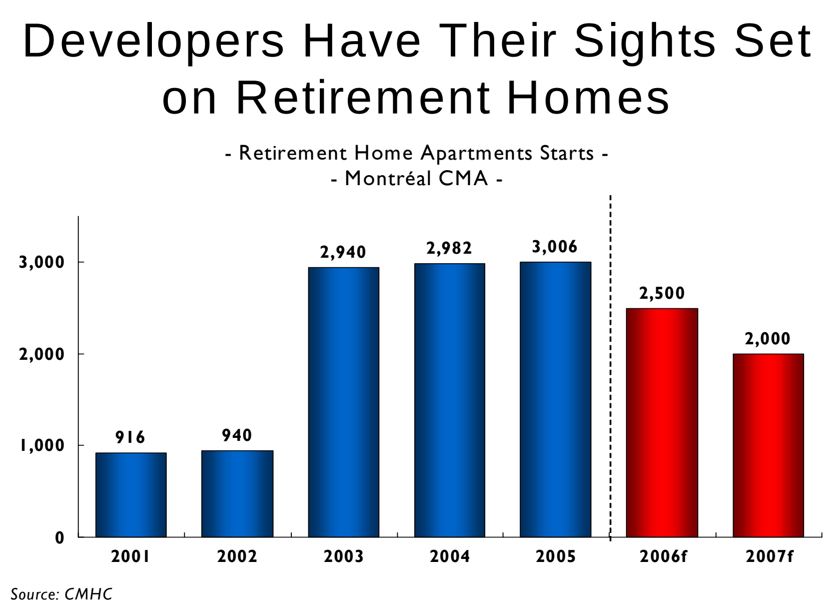
For the past few years, GDP growth in the Montréal area has been below the growth observed in Canada overall. So far, 2006 is no exception since, after three quarters, economic growth was estimated at 1.8 per

IN THIS ISSUE

cent in Quebec's largest metropolitan area, compared to 3 per cent for the whole country. We are anticipating a similar economic performance in 2007. While our exports may decline again next year, given that the U.S. economy is expected to weaken, the public sector will provide major local investments, particularly for the construction of the two university megahospitals.

Likewise, the job creation rate in the Montréal area is currently moderate (with a gain of some 16,000 jobs in 2005). It is the manufacturing sector that is experiencing difficulties, contending with the high value of the Canadian dollar and energy costs. The years 2006 and 2007 will probably be very similar in terms of job gains. For each of these two years, we anticipate increases of about 1 per cent in the number of employed workers. Fortunately, although the job market is not having its best years, the positions created over the past decade (308,000 jobs from 1996 to 2005) in the Montréal area are continuing to have positive effects on the housing market.

Figure 1



Source: CMHC

Residential construction

Freehold homes still in demand

The construction of freehold homes is doing well in the Montréal area. However, this segment cannot totally escape from the factors that are having a downward impact on residential construction overall (increase in inventories, latent demand satisfied, rise in listings on the resale market and slight rise in interest rates). This year, builders will have laid foundations for 9,000 houses in this market segment, down by 9 per cent from last year. The decrease extends to all geographic sectors, but the North Shore, where this housing type dominates, is more significantly affected.

Likewise, freehold home building will slow down somewhat next year (-6 per cent), but the level of activity will still remain steady, with 8,500 units to come.

Lastly, it should be noted that, with the progressive easing of the resale market (see next section), new home prices are currently rising faster than existing home prices, which is causing the new home market to lose some of its appeal.

Condominiums: some cranes being sidelined

Even though the year got off to a solid start, the notable decline observed in recent months leaves no doubt that 2006 will end with a decrease in condominium starts in the Montréal area. We are headed straight for the 7,000-unit mark, which will make for decreases of 20 per cent from last year and 30 per cent in relation to the all-time high registered in 2004 (10,053 units). Next year, a further drop is anticipated, but it will be smaller (-7 per cent).

The slowdown in condominium construction is not at all surprising, as the number of completed but unoccupied units of this type quadrupled in the last three years. In fact, despite the first signs that demand was slowing down at the end of the summer of 2004, supply continued to race ahead, which resulted in an increase in the number of unsold condominiums. At the same time, the number of existing condominiums for sale tripled since the low point recorded in 2002. In the short term, a downward adjustment in condominium construction was therefore necessary, and this adjustment will continue for a few more months in order to avoid an imbalance.

Rental housing: retirement homes yet again

In the last three years, the start-up of retirement housing projects (see Figure 1), a market segment where a shortage of units prevailed, was largely responsible for the increase in rental housing starts. Now, this year, as a result of a rise in the vacancy rate for this market segment (4 per cent in October 2005), the construction of such units will rather decline. This, combined with a slightly more modest level of activity in the conventional rental segment, as well, will lead to an overall decrease of around 25 per cent in rental housing starts. Consequently, this segment will register the greatest decline this year. For 2007, the same factors are leading us to forecast 4,500 rental housing starts, for an additional decrease of 10 per cent.

Part of the latent demand on the retirement home market therefore seems to have been met in several districts where there had previously been major shortages of apartments with services for seniors. Of course, given the aging of the population, this market will continue to grow at a steady pace over the coming years but, in the short term, the districts where there is still a lack of units of this type have become quite scarce.

In the conventional rental housing segment, as we may have mentioned before, the rents required to make large new projects profitable are such that they make it difficult for these buildings to compete with existing properties, on the one hand, and with the monthly payments needed to buy a lower- or mid-range condominium, on the other. For this reason, a limited level of activity should be expected in this market segment again next year.

Resale market

Market still very active

Despite the small rise in mortgage rates and, especially, the significant increase in prices in the last few years that caused demand to weaken somewhat, the volume of transactions is holding up on the resale market. This is because, in return, with the rise in listings, some buyers who had been turning to the new home market in recent years can now more easily find the property that they are looking for on the resale market. Consequently, it can be noted that part of the new housing demand is shifting toward the existing home market.

After registering a record number of trans actions in 2005, the Montréal census metropolitan area (CMA) resale market has remained dynamic in 2006. After three quarters, the volume of transactions is stable in relation to the first three quarters of 2005. We forecast that 2006 will end with 37,900 transactions, compared to 37,951 in 2005. In 2007, the market will still be just as active, with 38,000 transactions. Therefore, despite lacklustre economic conditions, activity on this market will be maintained, as medium-term interest rates will remain low (most buyers opt for mortgages with five-year terms).

The continued significant popularity of condominiums, more affordable and in line with the preferences of a broader client group, will ensure that this market segment will post the best sales performances, with gains of 5 per cent in 2006 and 4 per cent in 2007. Single-family home resales, however, will remain stable in 2006 and 2007.

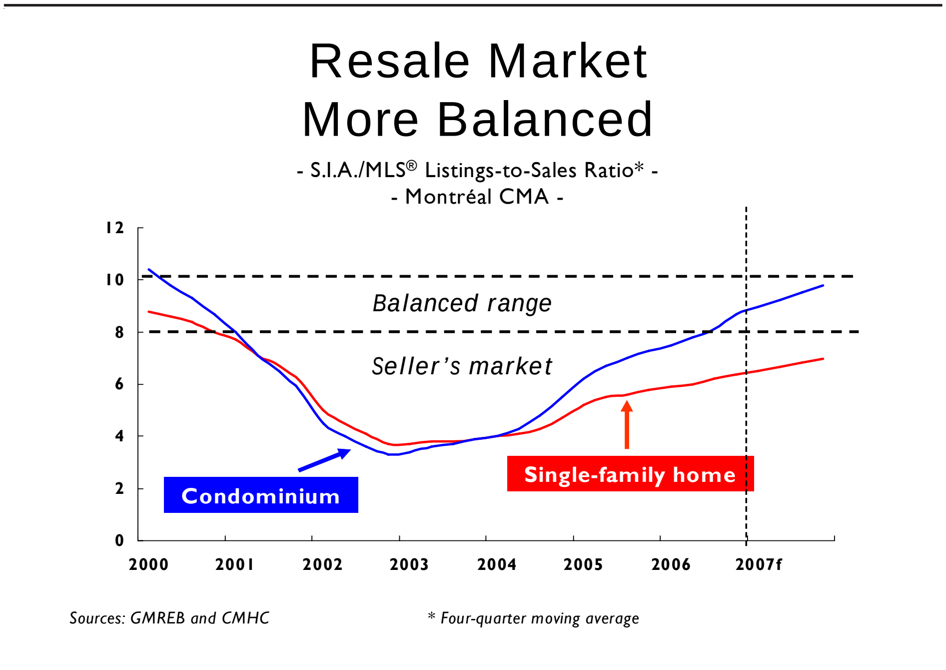
Rise in properties for sale draws market toward a more balanced state

After letting sellers get the long end of the stick since the beginning of the decade, buyers can finally breathe a little easier, as there are now more properties for sale (probably because of the rapid increase in the housing stock in recent years). Overall, the market still gives a slight edge to sellers, but it is gradually becoming more balanced.

At the end of 2006, a monthly average of 22,000 properties will have had "For Sale" signs in the CMA, for an increase of 13 per cent over 2005. While listings were scarce a few years ago, there are currently twice as many listed properties as in 2002. In 2007, we believe that listings will rise slightly less rapidly (+11 per cent), as their rate of increase has been slowing down somewhat for the past few quarters.

Condominium listings (+26 per cent in 2006 and +18 per cent in 2007) will rise

Figure 2



more rapidly than single-family home listings (+10 per cent and +9 per cent), while plex listings will be stable in 2006 before increasing by 8 per cent in 2007. The condominium segment will therefore continue on its way to becoming a more balanced market, such that, in 2007, sellers will have lost their advantage in the negotiation process, in a majority of districts.

Prices to rise more moderately

A more balanced market also means more moderate price increases. In 2003, the growth in the average price of single-family houses was 18 per cent. This growth has since slowed down progressively, and the average price of homes of this type will rise by 8 per cent in 2006 and by 5 per cent in 2007. The condominium market, which registered the strongest rise in listings, will post smaller increases in the average price (+5 per cent in 2006 and +3 per cent in 2007). Finally, the average price of plexes will grow by 8 per cent in 2006 and by 5 per cent in 2007.

Rental market

More vacant units

The rental market will continue to ease gradually in 2006 and 2007. The vacancy rate will reach 2.5 per cent in 2006, compared to 2 per cent in 2005. The rate should also rise modestly in 2007 and attain 3 per cent. However, this small increase conceals forces that do not all converge in the same direction.

The increase in the vacancy rate in the CMA since 2001 is certainly not unrelated to the fact that many renters have accessed homeownership in recent years. While many more renters will become homeowners over the coming years, they will likely be slightly less numerous. The recent small increase in mortgage rates and, especially, the significant growth in property prices are making it more difficult to access homeownership. The growing gap between the average monthly mortgage payment and the average rent will encourage some potential buyers to remain renters. Consequently, with the height of the homeownership wave most likely behind us, the number of dwellings so vacated will decrease.

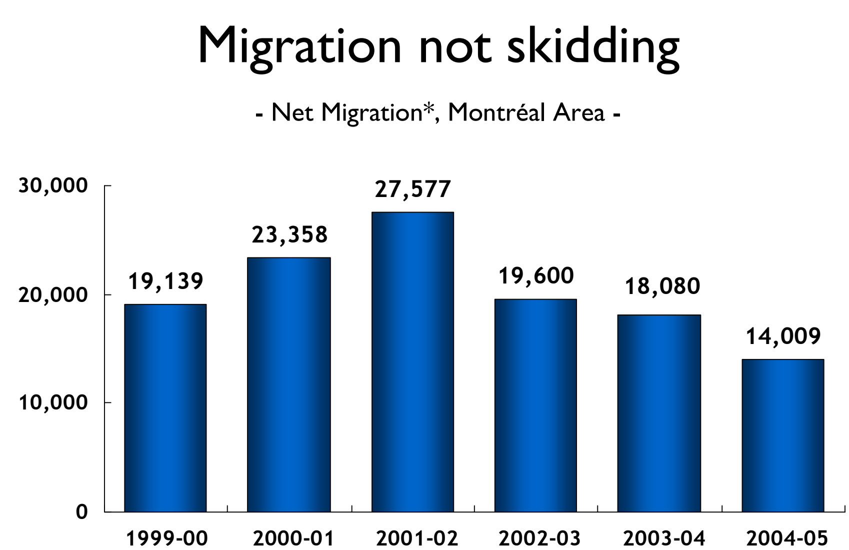
Still on the demand side, the latest migration figures for the Montréal CMA show that net migration was lower in 2004-2005 (+14,000 newcomers), as more and more residents of the Montréal CMA are moving out to the surrounding areas. It is only because of international migration that the net level is positive. Migration therefore continues to support the rental housing demand, but to a lesser extent than in recent years.

As well, young people aged from 15 to 24 years, who account for a significant share of the rental housing demand, saw their situation improve slightly in 2006. After declining over the last two years, employment for this age group went up by 3 per cent (+7,500 jobs) during the first eight months of 2006. More young people will therefore have the means to be renters in 2006 and 2007, which will somewhat stimulate demand for rental housing.

Finally, on the supply side, there will be 5,000 and 4,500 new rental housing units built in 2006 and 2007, respectively, representing lower volumes than in recent years. The supply will therefore increase more slowly, which will limit the rise in the vacancy rate in 2007. It should be noted that half of the anticipated units will be intended for the retirement home market and will therefore satisfy another significant share of rental housing clients, namely, seniors.

In 2007, based on pure market logic, with a rise in the vacancy rate, the increase in the average rent should be smaller. This increase is estimated at 2.5 per cent. However, given the new property assessment rolls taking effect next year in many municipalities, including Montréal, a greater increase in the average rent should be expected if these new rolls result in higher rental property operating expenses being passed on tenants. At the time of writing, the new taxation rates that will apply were still not known.

Figure n° 3



Sources: Statistics Canada and ISQ (compilations)

** Including net non-permanent residents*

Forecast Summary

Montréal Metropolitan Area

Third Quarter2006

	2004	2005	2006*	2007*	Chg. (%) 2006 vs 2005	Chg. (%) 2007 vs 2006
RESALE MARKET						
MLS Sales (1)						
Single-family houses	23,846	23,801	*23,700*	*23,600*	0%	0%
Condominiums	7,991	8,912	*9,400*	*9,800*	5%	4%
Plexes (2 to 5 units)	5,576	5,238	*4,800*	*4,600*	-8%	-4%
Total	37,413	37,951	*37,900*	*38,000*	0%	0%
Active MLS listings						
Single-family houses	9,434	11,454	*12,600*	*13,700*	10%	9%
Condominiums	3,690	5,400	*6,800*	*8,000*	26%	18%
Plexes (2 to 5 units)	2,347	2,603	*2,600*	*2,800*	0%	8%
Total	15,470	19,458	*22,000*	*24,500*	13%	11%
Average MLS price						
Single-family houses	207,908	222,915	*240,000*	*252,000*	8%	5%
Condominiums	181,571	191,623	*202,000*	*208,000*	5%	3%
Plexes (2 to 5 units)	262,904	289,512	*312,000*	*328,000*	8%	5%
NEW HOME MARKET						
Housing Starts						
Single-family houses	12,177	9,871	*9,000*	*8,500*	-9%	-6%
Condominiums	10,053	8,758	*7,000*	*6,500*	-20%	-7%
Rental housing units	6,443	6,687	*5,000*	*4,500*	-25%	-10%
Total	28,673	25,317	*21,000*	*19,500*	-17%	-7%
Average new house price						
Detached houses ($)	251,365	276,017	*304,000*	*328,000*	10%	8%
Semi-detached houses ($)	188,786	199,829	*210,000*	*220,000*	5%	5%
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*	*(5.5 - 6.5)*	1.2%	–
Mortgage rate 5-year (%)	6.2	6.0	*6.7*	*(6.0 - 7.0)*	0.7%	–
Employment (in thousand)	1,806	1,822	*1,840*	*1,860*	0.9%	1.1%
Annual employment variation (in thousands	19	16	*18*	*20*	–	–
Unemployment rate (%)	8.6	8.7	*8.9*	*9*	–	–

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
*** Does not take into account changes to property taxes*

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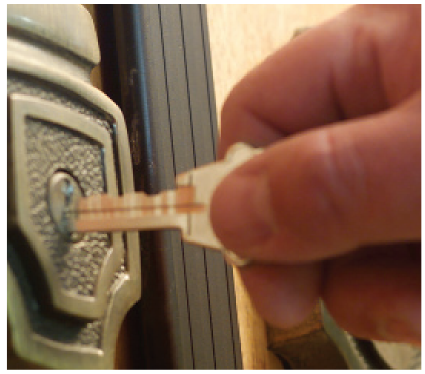


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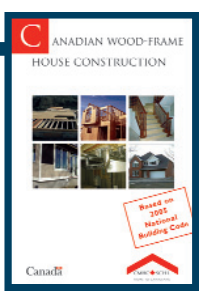

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