

# HOUSING MARKET INSIGHT

## Quebec CMA



CANADA MORTGAGE AND HOUSING CORPORATION

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*“While the rise in supply of traditional rental units recently accelerated, there is every reason to believe the growth in demand is likely to slow down. In this context, an increase in the vacancy rate is expected by 2017. Until then, however, a slowdown in housing starts is anticipated, which will allow the gradual absorption of units completed this year. However, there is nevertheless a risk of overbuilding.”*

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## Traditional rental market:<sup>1</sup> the growth in supply accelerated in 2015, but what about future demand?

*In 2015, strong activity was observed in the new rental housing segment in the Québec census metropolitan area (CMA). In a context where housing starts are multiplying and the vacancy rate is rising,<sup>2</sup> it is essential to focus on the future rental housing supply and demand for a better evaluation of the forces involved and the possible impacts on the market. Population projections are a solid basis to estimate future rental housing demand. Nonetheless, other factors, more difficult to anticipate, also have to be considered, including the trend of the percentage of renter households—since homebuying evolves over time—, demographic changes, such as the aging of the population, and generational differences. In this context, the three scenarios developed all revealed a downward trend in renter household formation. This trend will coincide with the addition of a large number of completed units this year. Therefore, a rise in the vacancy rate is expected by 2017. While renters will have more choice, owners will be faced with several challenges, since they will have to account for a more competitive environment and offer housing types that will better*

<sup>1</sup> “Traditional” rental units target a broad clientele and are found in private buildings with three or more rental units (excluding seniors’ residences).

<sup>2</sup> The vacancy rate is rising, as evidenced by the latest results of the Rental Market Survey conducted by CMHC last October: it increased from 3.1 per cent to 4 per cent between 2014 and 2015 in the Québec CMA.

meet the needs and aspirations of households who will opt for a rental unit. Let us add that if housing starts remain at high levels, signs of overbuilding<sup>3</sup> could be observed in the CMA.

## Estimating future rental demand

### The demographic slowdown will set the tone

The demographic outlook is an essential working basis for estimating future rental housing demand. Indeed, the number of households formed over time is a reference point to assess the number of future additional units required, all housing types combined. The population projections alone indicate a slowdown in the growth of total housing demand<sup>4</sup> in the medium and long term.

However, other key factors come into play when estimating future rental housing demand: the trend of the percentage of renter households—since homebuying evolves over time—, demographic changes, such as the aging of the population, and generational differences.

### Growth of homebuying continues to trend

Despite the high proportion of renter households, the long-term trend has continued to be the growth in homebuying—and thus the homeownership rate. Ten or twenty years ago, the percentage of renters was higher than today.<sup>5</sup>

It must also be noted that over the last few years, low mortgage rates and the market conditions observed in the region have been conducive to homebuying: the proportion of renter households has thus declined, decreasing from 44 per cent in 2001 to 41 per cent in 2006, and then to 40 per cent in 2011, at the time of the last census. Some periods were more favourable to homebuying than others, so that the trend has not been consistent over the past few years.

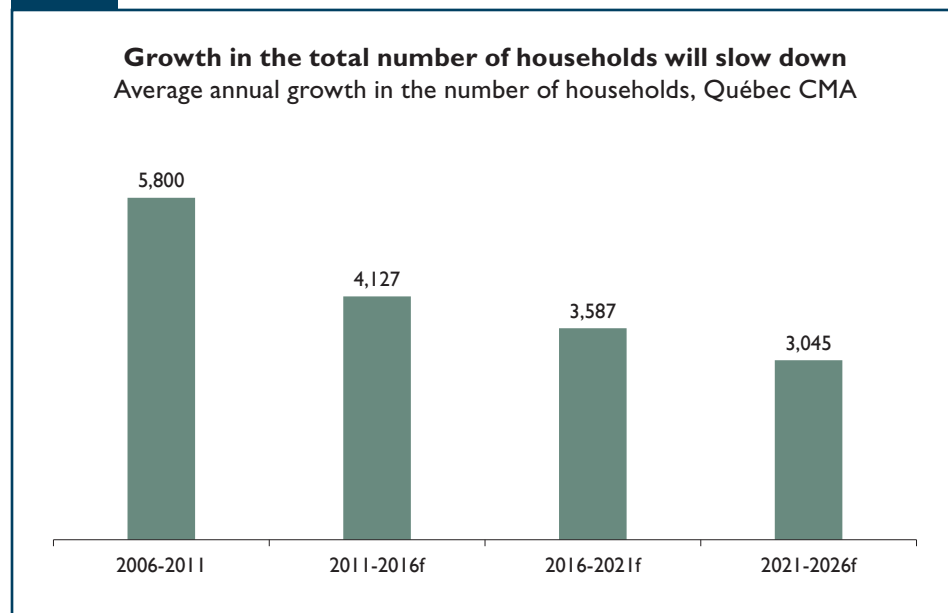
Nonetheless, it is obvious that the trend, observed in the medium and long term, must be considered when estimating future rental housing demand. The rate of renter households therefore tends to diminish over time, unless there is a significant deterioration of economic conditions.

## The aging of the population will affect rental housing demand

The aging of the population aging will also have an impact not only on the profile of the rental clientele, but on the size of demand. Indeed, it has been observed that there seems to be some return to rental tenure as the population ages.

The majority of young households are renters. Then, older households are mainly homeowners: 31 per cent of the 25-34 age group were renters in 2011. Finally, as households age, there seems to be a certain return to the rental market: 54 per cent of older households aged 75 and over were renters in the last census.

Figure 1



f: forecast

Sources: Statistics Canada, Institut de la statistique du Québec (Perspectives démographiques du Québec et des régions)

<sup>3</sup> According to the *Housing Market Assessment*, the analytical framework developed by CMHC, the Québec CMA shows signs of overbuilding, based on a 6-per-cent vacancy rate.

<sup>4</sup> Homeowner units and rental units

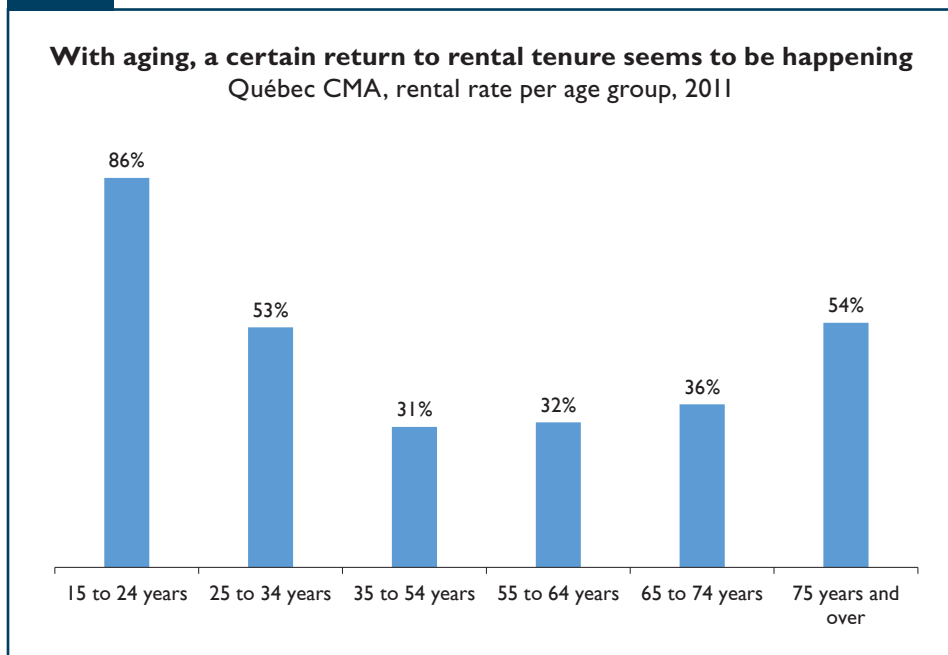
<sup>5</sup> Statistic Canada (census data)

However, this picture is static, because it is a “snapshot” taken during the last census, which does not account for generational differences. It is known, for example, that the homeownership rate is higher for baby boomers than for previous generations. Given that a large proportion of them will turn 65<sup>6</sup> over the next few years, it is relevant to ask if some will return to the rental market. Moreover, what residential choices will this important cohort make as they reach retirement age?

In addition, is it reasonable to assume that the rental market will grow as a result of the similarities with the condominium market, but without the related responsibilities: condominium fees, maintenance and repair, etc.? Recently, the expansion of the condominium market was supported by the demand from young households seeking affordable housing types and by the growth in the number of older households, most of which are baby boomers. Could it be possible that this housing product, more adapted to the lifestyle sought by some baby boomers, has reached its peak popularity, while the rental market, for its part, has not achieved its full potential? If the rental market’s attraction for baby boomers reaching retirement age is confirmed over the next few years, the rental rate of households aged 65 and over could be stable or even increase; this is a hypothesis to consider.

There is currently little data available regarding the residential trajectory of baby boomers reaching retirement age, because they only began to reach this stage in 2011. We will therefore have to wait for the next censuses for more extensive data on this subject.

Figure 2



Source: StatisticsCanada, 2011 Census

In the meantime, it is interesting to address the coming trends with different scenarios, based on the population projections.

**Future rental housing demand: three scenarios that do not reverse the trend**

From the outset, it is important to specify that the methodology used allows overall rental demand to be estimated, because it accounts for different scenarios that affect the renter rate as a whole. Thus, there is no differentiation among the different rental housing types, whether traditional rental units or seniors’ housing, for example. The methodology used seeks first and foremost to estimate the trend in overall rental housing demand over the next few years. Common to all the scenarios are the population projections by age group in the Québec CMA by 2021.<sup>7</sup>

Three scenarios have been evaluated:

**Low:** This scenario is the result of calculations based on tracking generations and the tenure chosen (renter or homeowner) between 2006 and 2011. Nonetheless, the data are incomplete, because the choices the baby boomers will make in the years ahead are not yet known precisely. Assumptions therefore shape this scenario for the oldest groups.

**Moderate:** This scenario is based on a gradual movement to homeownership, corresponding to the annual average reduction in the percentage of renters per age group observed between the 1996 and 2011 censuses. The average annual reduction of the renter rate has been applied up to 2021 for calculation purposes.

**High:** This scenario considers that the renter rate per age group is stable and corresponds to what was observed during the last census

<sup>6</sup> Households who will enter the 65-74 age group by 2021 were born between 1941 and 1956 and include a large proportion of the baby boomers (born between 1946 and 1965).

<sup>7</sup> Institut de la statistique du Québec (*Perspectives démographiques du Québec et des régions*)

(2011). This scenario is considered optimistic, because the renter rate rather tends to diminish over time. Therefore, this scenario does not account for the movement to homeownership. However, it could reflect a certain enthusiasm for the rental housing market by baby boomers reaching retirement age.

### The results of the three scenarios are indicative of a weakening growth in the number of new renter households

Regardless of the scenario considered, the results all point to a weakening growth in the number of new renter households. This trend is explained by the slowdown in population growth expected by 2021. Only two factors could reverse this trend: population growth stronger than forecast or a much greater than anticipated percentage of baby boomers opting to rent at retirement.

Overall, the future rental demand should rise, but at a less sustained pace than over the past few years. However, this picture conceals realities that vary according to the rental market segment.

### Rental market segments will not be affected in the same way

By further detailing the results of the moderate scenario, we catch a glimpse of the impacts aging will have on rental housing demand: a decline in the younger clientele will be noticed, while the baby boomers will represent a larger proportion of the demand. Finally, the growth in households aged

75 and over will accelerate and will probably affect the demand for seniors' housing units.

Consequently, the seniors' housing segment will probably benefit from this potential older clientele. The traditional rental market will therefore face a slowdown in demand growth over the next few years.

### Will the future rental housing supply be aligned with the demand trend?

#### The majority of the rental supply consists of traditional rental units

The Québec census metropolitan area (CMA) ranks fourth among Canada's large urban centres for the size of its rental stock.

Only the Montréal, Toronto and Vancouver CMAs surpass the Québec CMA in this regard. It must be said

that a large proportion of households in the region are renters. In fact, in the last census,<sup>8</sup> 40 per cent of Québec CMA households were renters.

In 2014, the number of renter households was estimated at 145,560. The overall supply required to meet this demand is composed of several types of rental units, including *traditional* rental units.

These units are intended for a large clientele and are found in private rental buildings with three or more units. It is estimated that this market segment represents 56 per cent of the rental supply of the Québec CMA. The rest of the supply is composed of seniors' housing, rental condominiums and other units rented (social housing, units in co-operatives, upper duplexes, single-detached homes, etc.).

Average number of renter household formed each year Québec CMA			
Between the 2006 and 2011 censuses			
2006–2011	1,700		
Scenarios	Low	Moderate	High
2011–2016 <sup>e</sup>	550	950	1,700
2016–2021 <sup>e</sup>	-50	600	1,400

e: estimate

Sources: Statistics Canada, Institut de la statistique du Québec

Calculations: CMHC

Average number of renter household formed each year Québec CMA				
Moderate scenario	Under 65 years	65 to 74 years	75 years and over	Total
2016–2021 <sup>e</sup>	1,060	+600	+1,060	+600

e: estimate

Sources: Statistics Canada, Institut de la statistique du Québec

Calculations: CMHC

<sup>8</sup> Statistics Canada, 2011 Census

## Housing starts: 2015, an especially active year in the traditional rental housing segment

There was strong activity in the traditional new rental housing segment in 2015. A total of 2,447 housing starts of this type were started, compared to 1,184 in 2014. The year 2015 thus represents a historic high.

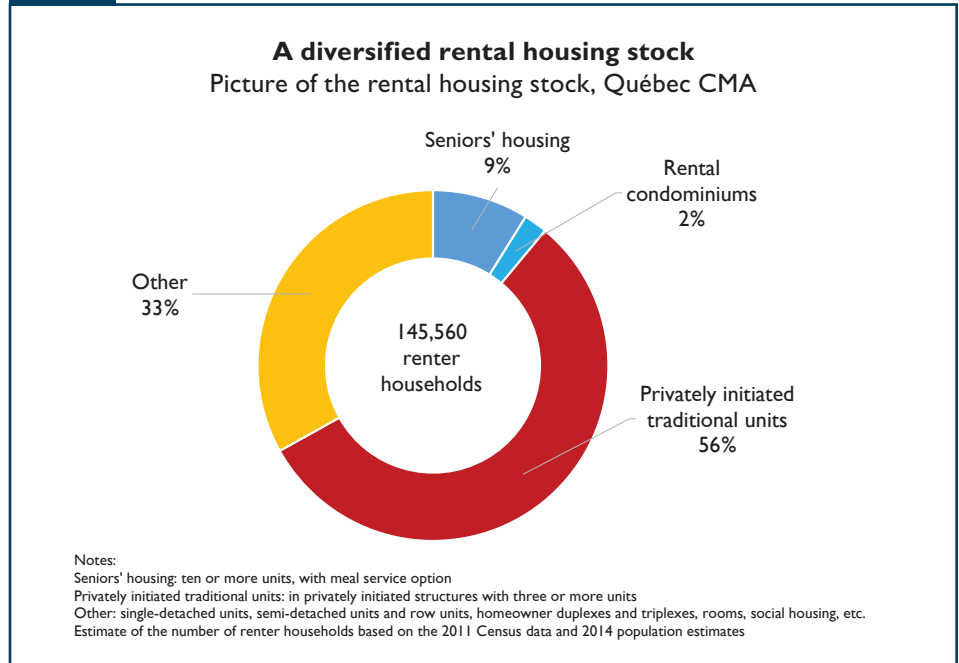
The relatively large condominium inventories and the search for new markets in order to maintain a certain level of activity are among the developers' motivations in going ahead with building projects, which are often large-scale.

Indeed, seven buildings with more than 100 units are among the housing starts. These buildings, most often presented as *upscale* products (concrete, soundproofing, luxury finish), include amenities, such as underground parking, common areas, a swimming pool, a spa and air conditioning. In addition, in marketing these projects, the units are often qualified as "rental condominiums" to refer to the quality of construction, the more luxurious design and the services offered.

## Traditional rental housing starts in 2016 and 2017: an adjustment phase is expected

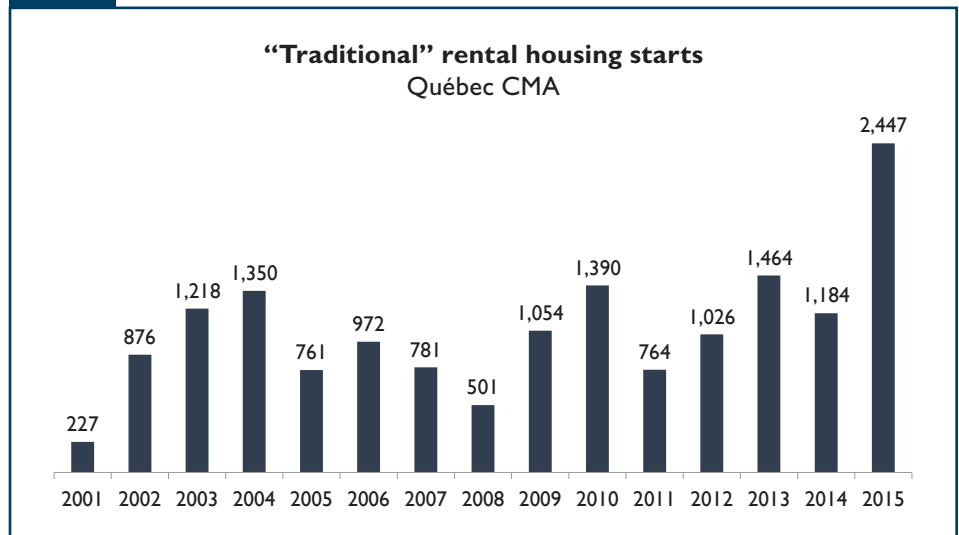
Apart from the major activity on the new home market, the recent trend on the traditional rental market must also be considered. The vacancy rate is rising, as evidenced by the latest results of the Rental Market Survey conducted by CMHC last October: it increased from 3.1 per cent to 4 per cent between 2014 and 2015 in the Québec CMA.

Figure 3



Sources: CMHC, StatisticsCanada, CMHC calculations

Figure 4



Source: CMHC

This, combined with the slowdown in the growth in demand and the large number of units that are expected to be completed this year, should translate into a decrease in housing starts by 2017. It should be noted that several major projects will be in the

absorption phase during that period. After an active year on the new home market, it is expected that 2016 and 2017 will be adjustment years with approximately 800 to 1,000 housing starts per year, at most.

However, if housing starts exceeded this level, the vacancy rate could then increase beyond 5 per cent by 2017, which would contribute to an overbuilding situation.<sup>9</sup> While this scenario remains possible, there is every reason to believe that builders will slow the pace this year and next year.

### **Match between supply and demand: several factors have to be considered**

Given the downward trend of demand growth, the addition of a large number of new traditional rental units on the market will drive up the vacancy rate, which will increase by 2017. In this context, renters will have a wider choice. Developers, for their part, will have to account for the magnitude of the future demand and conduct market studies to assess correctly its characteristics—particularly with regard to the demand for *upscale* products.

In the Québec CMA, it is noted that the proportion of renter households in the 65 to 74 age group with incomes of \$60,000 or over was only 20 per cent in the last census.<sup>10</sup> This is not the only indicator that must be considered, because it excludes household wealth (assets), but it nonetheless provides an overview of the proportion of households with above-average income and who potential—solely on the basis of income—can afford to opt for more expensive housing.

### **Conclusion**

While the pace of the supply of traditional rental units is accelerating, the growth in demand is bound to slow down. In this context, the vacancy rate will increase by 2017. Nonetheless, a slowdown in housing starts is expected, which will allow the gradual absorption of the units that should be completed this year. A risk of overbuilding<sup>11</sup> exists, however, if the pace of housing starts does not adjust better to the demand trend.

Given this context, renters will have more choices. Owners will face several challenges, because they will have to account for a more competitive environment and offer housing types that meet the needs and aspirations of households who will opt for rental housing.

Consequently, conducting market studies for new projects prior to building and maintaining older buildings become important factors to consider.

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<sup>9</sup> According to the *Housing Market Assessment*, the analytical framework developed by CMHC, the Québec CMA shows signs of overbuilding, based on a 6-per-cent vacancy rate.

<sup>10</sup> Statistics Canada, special compilations, 2011 Census, Québec CMA

<sup>11</sup> According to the *Housing Market Assessment*, the analytical framework developed by CMHC, the Québec CMA shows signs of overbuilding, based on a 6-per-cent vacancy rate.

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