SPOTLIGHT ON HOUSING

The Residential Sector Will Remain Under Pressure at the Beginning of 2022

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The resale market's strength at the end of 2021 helped conclude the year on a high note in both Ontario and Quebec. The anticipated interest rate hikes are generating a certain urgency among buyers, a situation that should last until at least the spring. The extremely low inventory of properties for sale will continue to put pressure on prices for now. Still, the increases should ease off as demand slows in response to higher mortgage rates, and prices may even adjust next year. Moreover, new construction will move away from the cyclical peak reached last year, and the slowdown will mostly affect single-family homes. In short, there will a number of things to keep an eye on after the frenzied activity in the residential sector.

An Extremely Tense Resale Market

Last year, rapidly rising prices affected the 6 major urban centers in Quebec, especially Gatineau, Sherbrooke and Trois-Rivières, soaring upwards of 25% (table 1). Prices were up almost 20% in Montreal and 15% in Quebec and Saguenay. The context of bidding wars and multiple offers has expanded, to a lesser extent, outside Greater Montreal and neighbouring regions.

TABLE 1
Existing-property prices: Gatineau saw the biggest increase

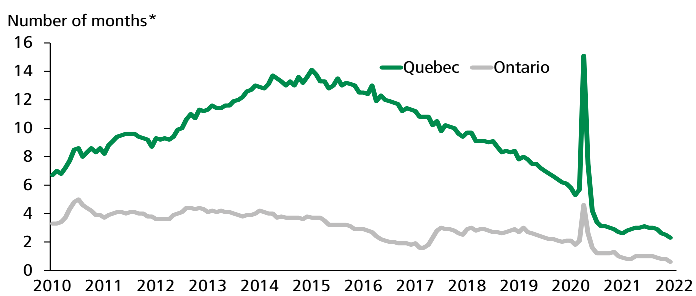
AVERAGE PRICE BASED ON CMA	YEAR 2021 Level in $	YEAR 2021 Annual variation in %
Gatineau	412,640	28.5
Montreal	564,306	18.5
Saguenay	227,173	12.8
Sherbrooke	373,405	28.1
Trois-Rivières	242,529	25.9
Quebec	333,688	13.3
All of Quebec	447,952	18.9

CMA: Census metropolitan area
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

In Ontario, the overheated markets caused prices to climb 15% to 30% in all census metropolitan areas (CMAs) last year. Average prices increased 17.9% in Toronto and 21.9% in Ottawa.

Low inventories of properties for sale, the strong demand for housing and the growing presence of investors (box on page 2) in certain markets caused prices to soar. This situation is expected to continue for a while, since the number of properties for sale on the market is still extremely low (graph 1).

GRAPH 1
There are very few existing properties for sale



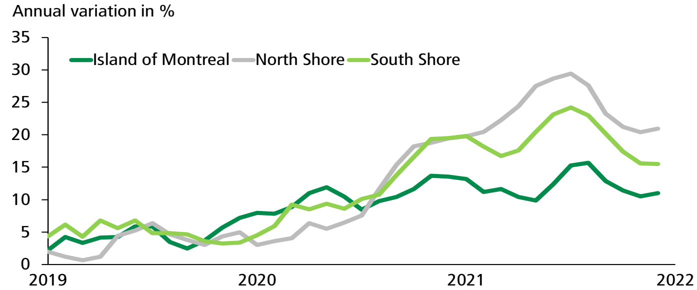
* The time required to sell off all properties at the current sales pace.
Sources: Canadian Real Estate Association and Desjardins, Economic Studies

However, a lull is forecast to begin in mid-2022 when rising interest rates start to affect borrowers. As a result, prices will increase more slowly this year (about 5% to 10%) in Quebec and Ontario, a pace well below the 18.9% and 22.8%, respectively, in 2021. Mortgage rate increases, which will continue in 2023, will slow the demand for housing even more and could lead

GRAPH 2
Property prices in Quebec: The period of price acceleration has ended

Sources: Canadian Real Estate Association and Desjardins, Economic Studies

GRAPH 3
Price increases slow in Montreal



Sources: JLR Land Title Solutions, Equifax Company and Desjardins, Economic Studies

to a slight 3% drop in prices in Quebec and Ontario next year (graph 2). Overpriced markets that are also being driven by strong investor demand like Montreal, Ottawa and Toronto are more vulnerable to a price adjustment in 2023.

Even if prices continue to climb in the short term, the pace will be slower than last year. This is already happening in the Greater Montreal Area (graph 3). However, prices are continuing to climb even higher on the outskirts of the Island due to the demographic trends studied by the Institut de la statistique du Québec. Many households left to settle along Montreal's North Shore or the South Shore, which has pushed up the demand for residential real estate and impacted prices.

New Homeowners Will Be More Affected

Rising mortgage rates should dampen the demand for housing, especially starting in the second half of 2022. First-time homebuyers will be the first to feel the impact, since new

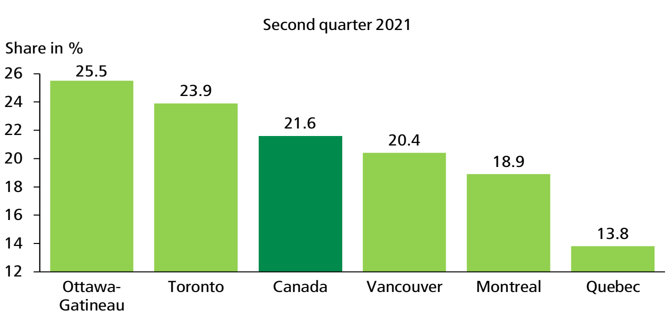
BOX

Investors Are Active

According to a recent study by the Bank of Canada (BoC), approximately 20% of property purchases in the country were investments by national investors taking out a mortgage in Canada. This type of acquisition is exacerbating the lack of homes available for households as well as putting additional upward pressure on prices. The presence of investors is the highest in Ottawa-Gatineau, followed by Toronto, Vancouver and Montreal (graph 4). They are not as noticeable in Quebec City. In non-urban areas throughout the country, investors are responsible for approximately 4% of all property purchases.

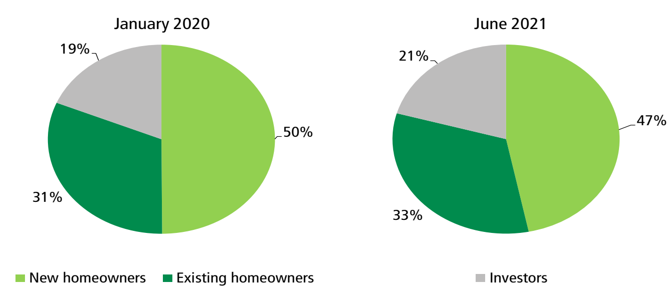
The role played by investors is growing and pushing up prices, which is detrimental to new homeowners (graph 5). First-time homebuyers generally have a smaller budget and less room to manoeuvre when it comes down to multiple offers. Even if the share of first-time homebuyers has dropped below 50%, they still outnumber experienced buyers and investors.

GRAPH 4
Investor property purchases* in Canada



* Purchases financed by a mortgage in Canada.
Sources: TransUnion, Bank of Canada and Desjardins, Economic Studies

GRAPH 5
Property purchases* in Canada: The share of new homeowners declines



* Purchases financed by a mortgage in Canada.
Sources: TransUnion, Bank of Canada and Desjardins, Economic Studies

loans will be granted based on the interest rates in effect. Still, the amount of an approved loan is not expected to be immediately affected, since it's already set at a rate higher than the one offered by the financial institution in accordance with federal government regulations. The rate used to calculate the maximum loan must be at least 5.25%. The purpose of this is to limit debt levels, which will give borrowers some wiggle room when interest rates go up again. Even if the amount of the loan granted remains unchanged, new homeowners will still face higher interest rates, which their monthly payments will reflect. As a result, the demand for housing should slow, since, according to the BoC, first-time homebuyers are responsible for almost 47% of all property purchases.

Impact on Homeowners: A Fixed or Variable Interest Rate?

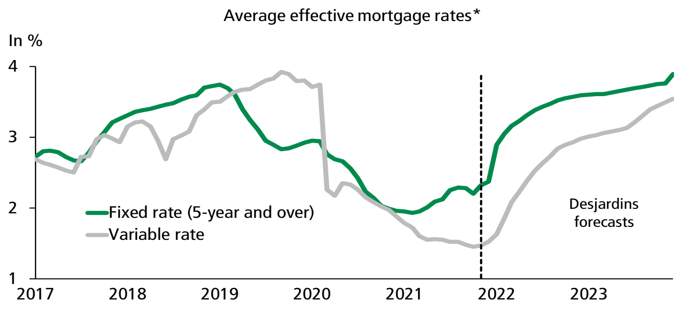
Borrowers who are already homeowners with a variable-rate mortgage will feel the effect of each 25 basis-point increase of the BoC's key rate. The first one is forecast for March, with 3 more expected by the end of 2022 and 2 more in 2023. So, the BoC's target rate will go from 0.25% currently to 1.75% by the end of next year. After remaining exceptionally low these last two years, variable rates will increase at the same pace until the end of 2023 but not reach pre-pandemic levels.

Most mortgage borrowers should have enough financial wiggle room to handle these increases. According to a recent *Economic Viewpoint*, Quebecers have amassed huge savings since the pandemic began and reduced their debt in the form of credit cards or personal lines of credit. Although debt has been climbing in recent quarters, it's still lower than before the crisis. Nonetheless, some households may struggle to meet their financial obligations when variable mortgage rates go up.

At Renewal Time, Not Everyone Will Lose

Fixed mortgage rates, which change based on investor expectations on the bond market, have already started to edge up after hitting bottom a year ago. The upward trend will continue over the next few quarters. Mortgage holders with a fixed interest rate won't necessarily see their monthly payments increase when the term expires. Everything will depend on whether the interest rate in effect at the time the mortgage is renewed is higher than the one when the loan was initially granted. For example, a borrower who took out a fixed-rate 5-year mortgage at roughly 3% or less in 2017 should be able to renew at a similar interest rate when the term expires in 2022, that is, around 3.0% to 3.5% (graph 6). Still, households that signed when fixed rates hit bottom in 2021 will certainly have to renew at a much higher rate. So, borrowers will have to think about the initial mortgage rate and what the new one could be when the term expires to determine what the effect will be when they renew.

GRAPH 6
Mortgage rates will be on the rise

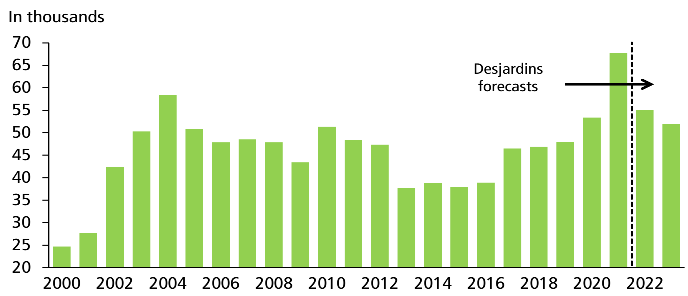


* Weighted average interest rate on cash advances.
Sources: Bank of Canada and Desjardins, Economic Studies

New Construction in a Slump

Housing starts were still on the rise at the beginning of 2021, then they started to fall. Quebec reached a historic high in January with 113,548 new homes started. From there, housing starts began to decline gradually before hitting 52,011 units in December, a return to normal after an extraordinary run caused by the pandemic. Our forecast is for 55,000 new homes this year and 52,000 next, a far cry from the 67,810 units reached in 2021 (graph 7). Higher interest rates will affect new construction, especially single-family homes. In contrast, the construction of rental units will remain strong (table 2 on page 4).

GRAPH 7
Housing starts: The level will remain high despite the slowdown



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

TABLE 2
Quebec housing market outlook 2022–2023

	2019	2020	2021	2022f	2023f
New housing market					
New construction ($B)	**11.7**	**13.0**	**17.7**	**15.5**	**14.5**
Annual variation (%)	-1.9	10.7	36.5	-12.7	-6.5
Housing starts	**47,967**	**53,364**	**67,810**	**55,000**	**52,000**
Annual variation (%)	2.3	11.3	27.1	-18.9	-5.5
House	**13,742**	**15,502**	**21,091**	**13,000**	**11,000**
Annual variation (%)	-8.2	12.8	36.1	-38.4	-15.4
Single-detached	***8,989***	***10,437***	***14,826.0***	---	---
Annual variation (%)	*-10.6*	*16.1*	*42.1*	---	---
Semi-detached	***2,966***	***3,457***	***4,175.0***	---	---
Annual variation (%)	*-1.0*	*16.6*	*20.8*	---	---
Row housing unit	***1,787***	***1,608***	***2,090.0***	---	---
Annual variation (%)	*-6.6*	*-10.0*	*30.0*	---	---
Apartment	**34,225**	**37,862**	**46,719**	**42,000**	**41,000**
Annual variation (%)	7.3	10.6	23.4	-10.1	-2.4
Condo [1]	***8,172***	***7,222***	***7,500***	***7,000***	***6,000***
Annual variation (%)	*-17.1*	*-11.6*	*3.8*	*-6.7*	*-14.3*
Rental [1]	***24,861***	***28,709***	***34,000***	***34,500***	***34,700***
Annual variation (%)	*21.3*	*15.5*	*18.4*	*1.5*	*0.6*
Conventional rental [2]	***21,536***	***26,554***	***32,000***	***32,500***	***32,700***
Annual variation (%)	*28.6*	*23.3*	*20.5*	*1.6*	*0.6*
Retirement home [2]	***3,159***	***2,017***	***2,000***	***2,000***	***2,000***
Annual variation (%)	*-11.4*	*-36.2*	*-0.8*	*0.0*	*0.0*
Resale market					
Unit sales	**96,636**	**112,176**	**110,514**	**101,380**	**88,705**
Annual variation (%)	11.8	16.1	-1.5	-8.3	-12.5
Weighted average price ($k)	**324**	**377**	**448**	**477**	**463**
Annual variation (%)	5.2	16.4	18.9	6.5	-3.0
Sales volume ($B)	**30.5**	**40.0**	**46.8**	**48.4**	**41.1**
Annual variation (%)	15.9	31.1	17.1	3.3	-15.1
Other indicators					
Vacancy rate for rental units[3] (%)	**1.8**	**2.5**	**2.8**	**2.3**	**2.3**
Average rent[3] ($)	**800**	**844**	**885**	**925**	**925**
Annual variation (%)	5.1	5.5	4.9	4.5	0.0
Renovation spending[4] ($B)	**14.2**	**14.2**	**18.5**	**18.0**	**16.0**
Annual variation (%)	3.9	0.1	30.1	-2.7	-11.1

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