

SPOTLIGHT ON HOUSING

Quebec’s Housing Market Will Continue to Correct in 2023 Before Likely Rebounding Next Year

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Quebec’s housing market will continue to slide this year. Housing starts were off 15.8% in 2022 and are projected to fall about 20% in 2023. With household borrowing capacity way down, demand for new homes is softening. And despite the rental apartment shortage, developers are postponing or cancelling some projects because they’re having trouble getting financing due to high interest rates. Existing home sales are expected to drop by 25% in 2023. That’s about on par with last year’s decline and close to a twenty-year low. The average home price in Quebec is down 8.1% from its April 2022 peak. That figure will likely hit 17% by the end of 2023. But the housing market should gradually rebound next year. Between the ongoing price correction and future mortgage rate cuts, affordability should improve. As existing home sales pick up, prices, housing starts and renovation spending should slowly recover in 2024.

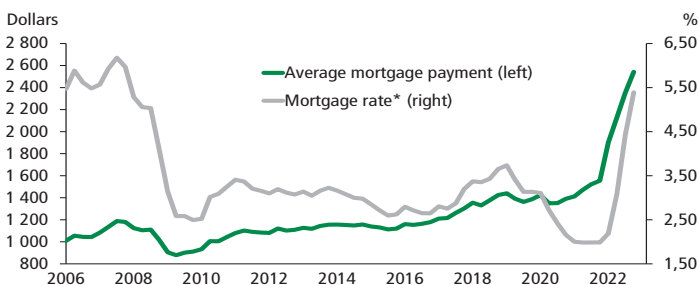
First-Time Home Buyers Have Been Sidelined

The housing market will continue to correct in 2023. While we should be nearing the end of mortgage rate hikes, monthly payments have skyrocketed (graph 1). The average home price in Quebec is \$465,000. For borrowers with a 10% down payment and a 25-year amortization, the average monthly payment was up to \$2,550 at the end of 2022 from a low of \$1,350 in the first six months of the pandemic two years ago. That’s over \$1,000 more per month!

It’s no wonder so many first-time home buyers have been sidelined—they tend to have less saved for a down payment. Even those getting financial help from family or friends are struggling to buy a home. According to a 2021 survey by the Association professionnelle des constructeurs en habitation du Québec (APCHQ), 20% of first-time home buyers received a gift and 10% got a loan from family or friends to help make their down payment. But given today’s high mortgage rates, monthly payments are out of reach for many first-time home buyers, whether they’re getting financial assistance or not.

Starting April 1, households can contribute up to \$8,000 per person per year to a Tax-Free First Home Savings Account (FHSA). That means over 5 years, they can set aside up to \$40,000. Contributions are tax deductible, and gains are tax-free. This will help households that haven’t owned a home in five years—and have the financial means—to build a down payment over several years. But because it will take time for buyers to save that money, housing demand won’t go up overnight. In fact, it won’t bring first-time home buyers back into the market anytime soon. And according to the most recent data, first-time buyers accounted for about half of home purchases before interest rates went up (graph 2 on page 2).

GRAPH 1
As Interest Rates Have Gone Up, Monthly Payments Have Skyrocketed for Quebec Home Buyers

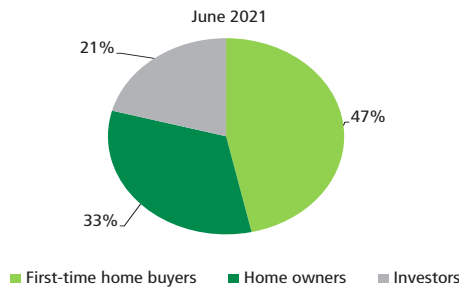


* Weighted average of fixed and variable mortgage rates for all loan terms.
Sources: Bank of Canada, Conference Board of Canada, JLR Land Title Solutions (an Equifax Company), Statistics Canada and Desjardins Economic Studies

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GRAPH 2
First-Time Buyers and Investors Accounted for a Large Share of Home Purchases* in Canada before Rates Went Up

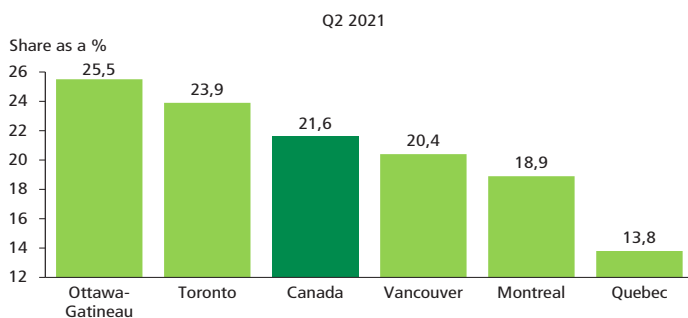


* Purchases financed by a Canadian mortgage.
 Sources: TransUnion, Bank of Canada and Desjardins Economic Studies

Investors Are Also Sitting on the Sidelines

Local and foreign investors accounted for about 20% of domestic home sales before interest rates rose, and they too are taking a breather. The Vancouver, Toronto and Ottawa-Gatineau markets in particular have seen less investor interest in the past few quarters. Now that soaring prices have given way to price corrections and the cost of borrowing is up, investor appetite has waned. This is happening in Montreal and Quebec City as well, but to a lesser extent since they don't attract as many investors (graph 3). At the same time, buying up homes to list as vacation rentals has become less attractive now that borrowers are facing high interest rates. In some resort areas, especially the Laurentides and Estrie, demand is down and inventories are up. Home sales plummeted 44% in Mont Tremblant in 2022, and the average price has begun to fall there as well.

GRAPH 3
Home Purchases* by Investors in Canada



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

The New Rules Will Hurt

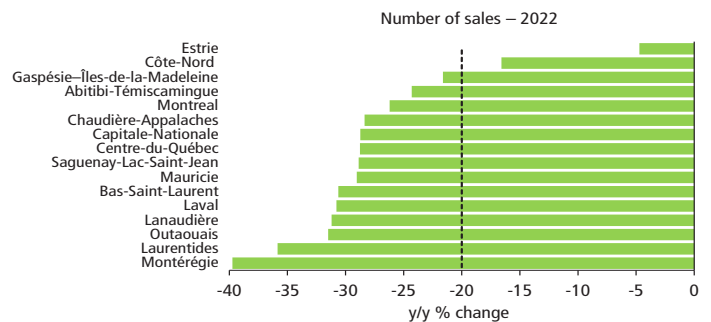
Two new federal government rules will pose additional obstacles for investors. As of January 1, 2023, non-residents of Canada are prohibited from purchasing real estate for two years. This will leave sellers with fewer potential buyers. The measure aims to curb investor activity and cut down on recreational rentals to

free up housing for people to actually live in. A second rule aims to limit flipping—the practice of buying property to sell it for a quick profit. Capital gains on the sale of any property sold within a year of purchase will be taxable as 100% business income rather than 50%. This won't affect contractors who renovate homes and sell them for a profit, but it will be a major deterrent for individuals. This year the housing market will therefore see both reduced investor activity and first-time buyers who continue to be sidelined.

Sales Are Down Provincewide

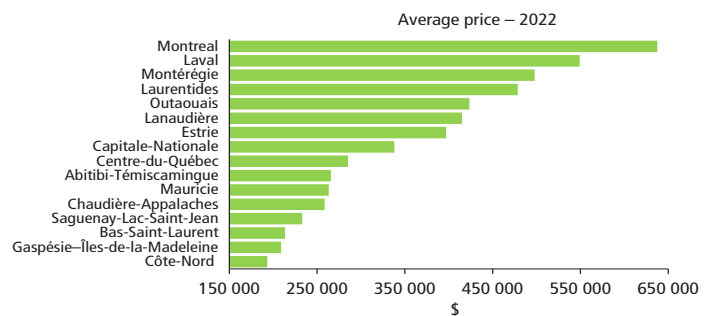
In most regions of Quebec, existing home sales were down more than 20% last year (graph 4). The Outaouais and the outskirts of the Island of Montreal saw declines of 30% or more. The Côte-Nord and Estrie held up better than the rest of the province, recording a much smaller decrease. In general, the most expensive markets experienced a sharper drop in demand last year (graph 5) as rising interest rates drove up mortgage payments. We expect a similar dynamic in 2023, with sales declining even faster in some regions.

GRAPH 4
Existing Home Sales Are Down All across Quebec



Sources: JLR Land Title Solutions (an Equifax Company) and Desjardins Economic Studies

GRAPH 5
The Island of Montreal and Several Surrounding Areas Continue to Have the Highest Average Home Prices



Sources: JLR Land Title Solutions (an Equifax Company) and Desjardins Economic Studies

In January, sales in Greater Montreal hit their lowest level since 2009. Compared to January 2022, sales were down 31% for single-family homes, 38% for condominiums and 52% for plexes. Meanwhile inventory is piling up across all home categories. That means selling times will continue to increase, and the growing imbalance between supply and demand will send prices even lower in 2023.

Prices Aren't down Everywhere in Quebec

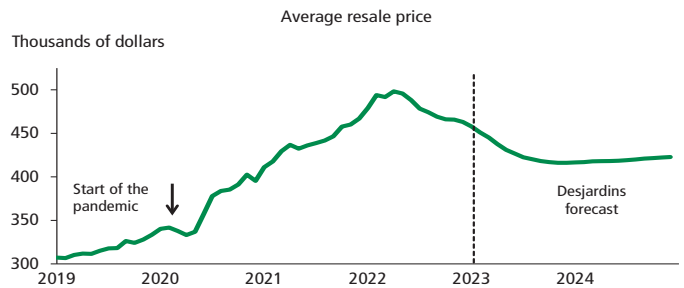
The average home price in Quebec fell 8.1% from its April 2022 peak to January 2023, and that figure is expected to hit 17% by year's end. So far, prices are down in the markets that saw a lot of bidding wars up until spring of last year, just before the housing market turned. This includes the Island of Montreal and surrounding areas, the Outaouais and parts of the Estrie. The price correction will continue in those areas and should begin elsewhere soon.

As we expected a few months ago, prices are holding up better in regions that saw little or no overbidding, such as northern, central and eastern Quebec. In the Greater Quebec City Area, sales aren't down as much and inventory remains tight. The median price for condos continues to go up, while single-family home prices have stabilized and prices for plexes are falling. We believe that as the housing market continues to correct this year, prices will decline more broadly, though they may hold steady or increase slightly in some regions.

Affordability Will Be the Key to Recovery in 2024

The housing market will continue to deteriorate in 2023, but we expect it to gradually recover next year. Affordability should improve on the back of ongoing price declines and future mortgage rate cuts (graph 6). But interest rates won't come down enough to entice large numbers of buyers off the sidelines. And the federal restrictions we discussed above will remain in place next year. As existing home sales rebound, prices should slowly start to recover in 2024 (graph 7).

GRAPH 7
Despite Quebec's Ongoing Housing Correction, Prices Will Remain above Pre-pandemic Levels



Sources: Canadian Real Estate Association and Desjardins Economic Studies

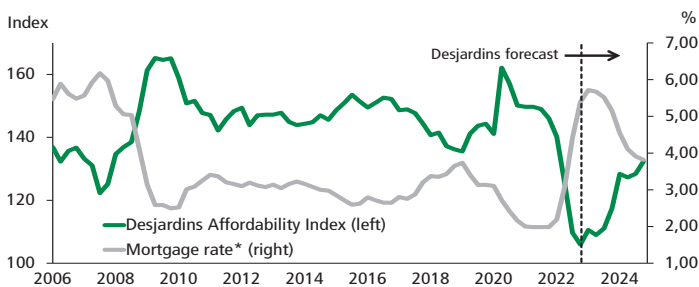
In the meantime, demand for new homes and condominiums will continue to soften as household borrowing capacity declines. High interest rates are making it tough for developers to turn a profit on rental projects, and we're already seeing a slowdown in construction. Even though rental apartments are in short supply, some projects are being postponed or cancelled as developers struggle to get financing. Senior housing construction has also been flat as the pandemic has reduced interest among independent seniors. In short, residential construction will continue to decline across all market segments this year (table on page 5) and won't recover until 2024.

Rents Will Continue to Soar

Not much will change in the conventional rental market this year. Demand will remain strong for a number of reasons, including obstacles to home ownership, the apartment shortage and immigration that has recovered from pandemic lows. On the supply side, new apartment construction was down about 10% in 2022 and is expected to decline at least 20% this year in Quebec. We're already seeing a drop in housing starts in most major urban centres and communities with 10,000 or more residents. Despite some government programs, getting project financing has been very challenging since interest rates started to rise. Barring a massive injection of public funds, relaxed regulations or additional support for municipalities, we'll continue to see less rental apartment construction, not more.

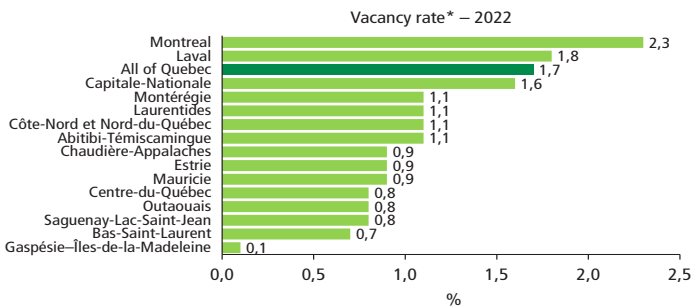
And the provincial vacancy rate will keep falling, likely approaching 1% this year compared to 1.7% in 2022. No region is immune to the rental housing shortage (graph 8 on page 4). Rents will continue to soar, climbing an expected 10% on average this year in Quebec. They're skyrocketing in many regions (graph 9 on page 4) as almost no apartments are available for rent. For both tenants and landlords in Quebec, the issue of housing affordability will be even more pressing in 2023.

GRAPH 6
The Desjardins Affordability Index Is Down Sharply in Quebec but Is Poised for a Rebound



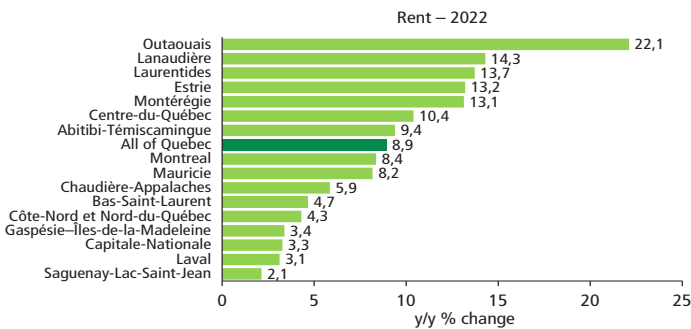
* Weighted average of fixed and variable mortgage rates for all loan terms. Sources: Bank of Canada, Conference Board of Canada, JLR Land Title Solutions (an Equifax Company), Statistics Canada and Desjardins Economic Studies

GRAPH 8
The Rental Vacancy Rate Is under 1% in Many Regions



* Data not available for Lanaudière.
Sources: Canada Mortgage and Housing Corporation and Desjardins Economic Studies

GRAPH 9
Rent Is Way Up in Many Regions



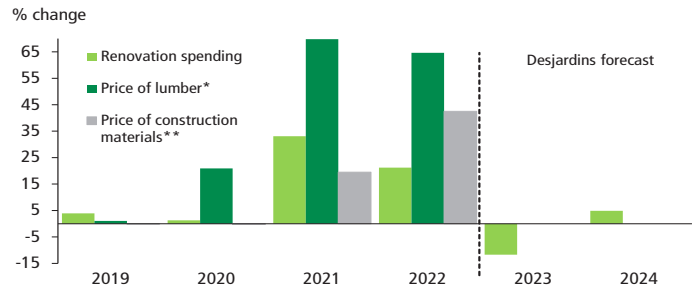
Sources: Canada Mortgage and Housing Corporation and Desjardins Economic Studies

In Short, the Correction Is Far from Over

The housing market began to cool last year and will continue to decline in 2023. We expect just 44,000 new homes to be built this year, the fewest since 2016. Meanwhile existing home sales could hit a nearly 20-year low. Rising mortgage rates have eroded affordability even as resale prices continue to fall in several regions of the province. But construction and renovation costs remain high, though material prices are down from their peak. Fewer projects are moving forward and some material prices will drop, resulting in less renovation spending (graph 10).

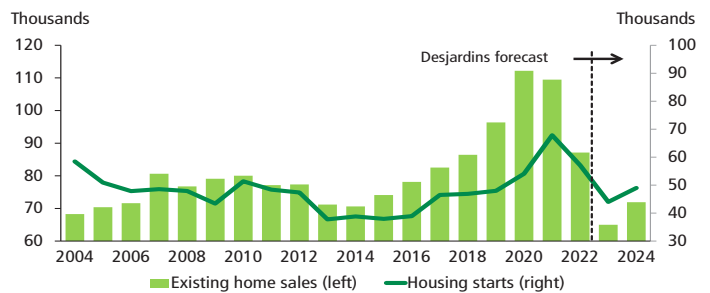
We’re seeing both activity and prices declining in all three market segments—the opposite of what happened during the pandemic. That said, Quebec’s housing market should start to recover in 2024 on falling interest rates (graph 11). But we won’t see the kind of housing frenzy we had a few years back when interest rates were at record lows.

GRAPH 10
Renovation Spending in Quebec Has Been Inflated by Soaring Material Prices



* Including other wood products; ** Including metal products.
Sources: Statistics Canada and Desjardins Economic Studies

GRAPH 11
Existing Home Sales and Housing Starts Will Plummet Again This Year before Recovering Somewhat in 2024



Sources: Canadian Real Estate Association, Canada Mortgage and Housing Corporation and Desjardins Economic Studies

TABLE
Quebec housing market outlook 2023–2024

| | 2019 | 2020 | 2021 | 2022 | 2023f | 2024f |
|---|--------|---------|----------|--------|--------|--------|
| New housing market | | | | | | |
| New construction (\$B) | 11.7 | 13.0 | 17.6 | 16.3 | 11.5 | 13.4 |
| Year-over-year change (%) | -1.9 | 10.7 | 35.4 | -7.2 | -29.6 | 16.5 |
| Housing starts | 47,967 | 54,066 | 67,810 | 57,107 | 44,000 | 49,000 |
| Year-over-year change (%) | 2.3 | 12.7 | 25.4 | -15.8 | -23.0 | 11.4 |
| Houses | 13,742 | 15,995 | 21,091 | 16,825 | 12,000 | 13,000 |
| Year-over-year change (%) | -8.2 | 16.4 | 31.9 | -20.2 | -28.7 | 8.3 |
| Single-detached | 8,989 | 10,861 | 14,826.0 | --- | --- | --- |
| Year-over-year change (%) | -10.6 | 20.8 | 36.5 | --- | --- | --- |
| Semi-detached | 2,966 | 3,514 | 4,175.0 | --- | --- | --- |
| Year-over-year change (%) | -1.0 | 18.5 | 18.8 | --- | --- | --- |
| Row housing units | 1,787 | 1,620 | 2,090.0 | --- | --- | --- |
| Year-over-year change (%) | -6.6 | -9.3 | 29.0 | --- | --- | --- |
| Apartments | 34,225 | 38,071 | 46,719 | 40,282 | 32,000 | 37,000 |
| Year-over-year change (%) | 7.3 | 11.2 | 22.7 | -13.8 | -20.6 | 15.6 |
| Condos ¹ | 8,172 | 7,222 | 8,032 | 6,913 | 5,500 | 6,500 |
| Year-over-year change (%) | -17.1 | -11.6 | 11.2 | -13.9 | -20.4 | 18.2 |
| Rentals ¹ | 24,861 | 28,709 | 35,659 | 31,123 | 24,500 | 27,500 |
| Year-over-year change (%) | 21.3 | 15.5 | 24.2 | -12.7 | -21.3 | 12.2 |
| Conventional rentals ² | 21,536 | 26,554 | 33,049 | 30,078 | 23,600 | 26,500 |
| Year-over-year change (%) | 28.6 | 23.3 | 24.5 | -9.0 | -21.5 | 12.3 |
| Retirement homes ² | 3,159 | 2,017 | 2,567 | 980 | 900 | 1,000 |
| Year-over-year change (%) | -11.4 | -36.2 | 27.3 | -61.8 | -8.2 | 11.1 |
| Resale market | | | | | | |
| Unit sales | 96,349 | 112,159 | 109,467 | 87,129 | 65,005 | 71,920 |
| Year-over-year change (%) | 11.4 | 16.4 | -2.4 | -20.4 | -25.4 | 10.6 |
| Weighted average price (\$k) | 324 | 377 | 438 | 484 | 430 | 419 |
| Year-over-year change (%) | 5.2 | 16.4 | 16.4 | 10.3 | -11.0 | -2.5 |
| Sales volume (\$B) | 30.4 | 40.0 | 46.3 | 40.5 | 28.0 | 30.2 |
| Year-over-year change (%) | 15.5 | 31.5 | 15.8 | -12.7 | -30.9 | 7.9 |
| Other indicators | | | | | | |
| Vacancy rate for rental units ³ (%) | 1.8 | 2.4 | 2.5 | 1.7 | 1.2 | 1.0 |
| Average rent ³ (\$) | 800 | 845 | 874 | 952 | 1,050 | 1,125 |
| Year-over-year change (%) | 5.1 | 5.6 | 3.4 | 8.9 | 10.3 | 7.1 |
| Renovation spending ⁴ (\$B) | 14.2 | 14.4 | 19.2 | 23.2 | 20.5 | 21.5 |
| Year-over-year change (%) | 3.9 | 1.3 | 33.1 | 21.2 | -11.7 | 4.9 |

f: forecasts; ¹ Urban centres with populations of 10,000 or more, the total is slightly below the total for provincial apartments shown above; ² Included in rental units;

³ Three units or more, biannual survey conducted in 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