HOUSING MARKET ASSESSMENT
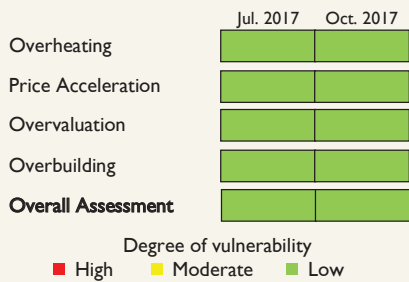## Montréal CMA

Date Released: Fourth Quarter 2017

Canada

CMHC ❖ SCHL

Highlights

Results Overview
Montréal CMA

	Jul. 2017	Oct. 2017
Overheating		
Price Acceleration		
Overvaluation		
Overbuilding		
Overall Assessment		

Degree of vulnerability
■ High   ■ Moderate   ■ Low

- In the second quarter of 2017[1], the degree of vulnerability for the Montréal census metropolitan area (CMA) housing market remained low, according to the Housing Market Assessment (HMA) analytical framework.

- Continued low evidence of overvaluation was the result of house prices remaining close to levels dictated by the economic and demographic fundamentals.

- Evidence of overheating and acceleration in the growth of prices stayed low. Still, the rise in demand contributed to further tightening of the resale market.

- Evidence of overbuilding also remained low. The inventory of completed and unsold units per 10,000 population continued to decline.

HMA Overview[2]

As Canada's authority on housing, CMHC contributes to market stability by providing information on potential imbalances that could affect housing markets. With the Housing Market Assessment (HMA), CMHC offers information and analysis that can help Canadians make more informed decisions.

The HMA combines the results from a technical framework with insights gained through CMHC's market analysts' knowledge of local market conditions. These insights position CMHC to provide additional context and interpretation to the results of the HMA framework.

The HMA framework detects problematic market conditions in local housing markets by identifying imbalances. An example would be the detection of overbuilding, a situation in which the inventory of unsold new homes accumulates on account of supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolve an excess supply imbalance by supporting stronger demand and/ or reducing supply. However, other unexpected developments that do not originate from the housing market could accentuate or reduce an imbalance. Colour codes indicate the level of evidence of problematic conditions.

The HMA is a comprehensive framework that considers the intensity of signals of imbalances (that is, how far the indicator is from its historical average) and the persistence over time. Generally, low intensity and persistence are associated with potential weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

[1] Results are based on data as of the end of June 2017 and local market intelligence up to end of September 2017. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

[2] A detailed description of the framework is available in the appendix of the National edition.

In Detail

Low evidence of overheating

In the second quarter of 2017, evidence of overheating remained low for the Montréal CMA resale market. In fact, the seasonally adjusted sales-to-new listings ratio was 60% (see figure 1), which is below the rate associated with potential imbalances on the market[3].

Still, this ratio was up very slightly compared to the previous quarter, reflecting a tightening resale market attributable to a decrease in new listings and an increase in Centris® sales. From now until the end of the year, the sales-to-new listings ratio should in fact continue to rise[4].

A second market indicator, the active listings-to-sales ratio[5], suggests that the Montréal resale market was balanced overall during the second quarter of 2017. However, conditions differed for the various types of

**Francis Cortellino**
Principal,
Market Analysis

"In the second quarter of 2017, the degree of vulnerability for the Montréal housing market remained low. The increase in activity on the resale market put upward pressure on prices, but economic and demographic conditions continued to support the level of prices observed."

Figure 1

Evidence of Overheating Remains Low
Sales-to-New Listings Ratio (%) - Montreal CMA
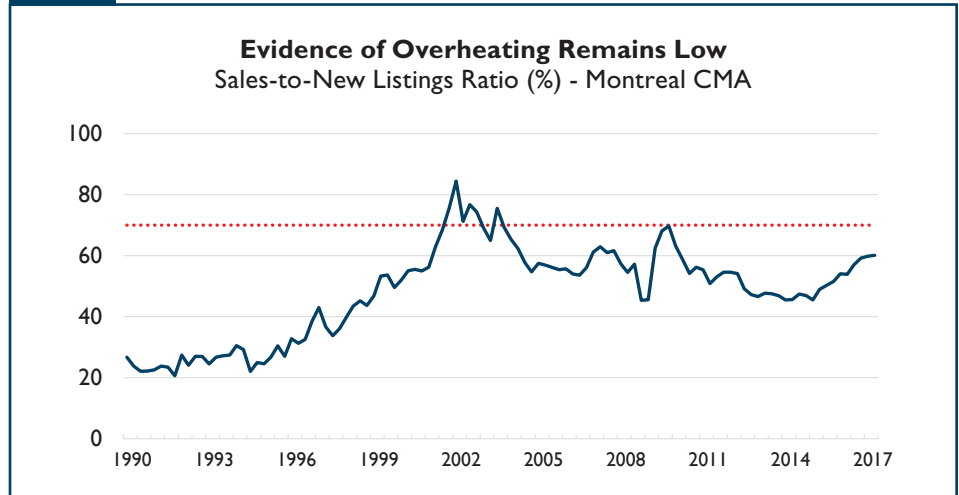
Source: Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC; Last data point: 2017 Q2.

Figure 2

Conditions Tightening Gradually on the Resale Market
Active Centris® Listings-to-Sales Ratio – Montréal CMA
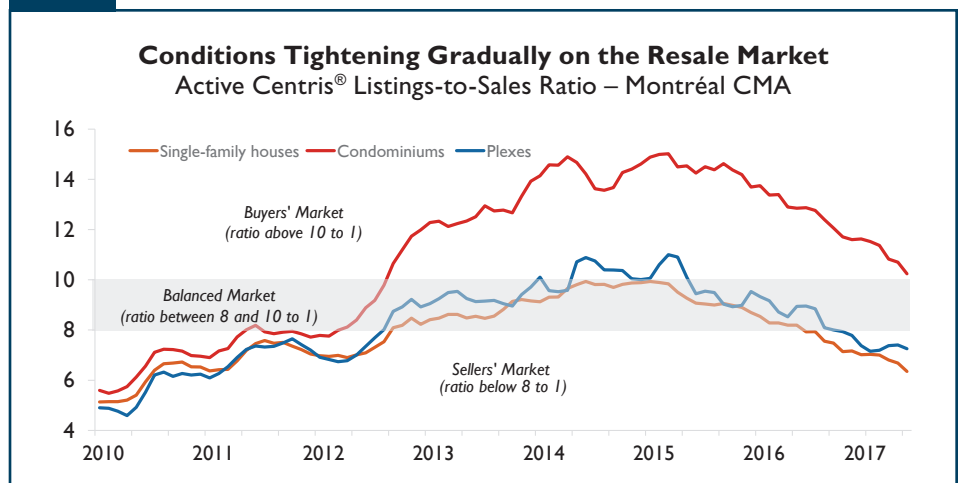
Source: QFREB by the Centris® system, seasonally adjusted data by CMHC, three-month moving average ; Last data point: June 2017.

properties (see figure 2). The single-family home and plex segments favoured sellers[6]. The conditions in these two segments were therefore somewhat tighter than in the condominium market, which remained favourable to buyers[7] but very close to balanced. Over the next

few quarters, given the expected increase in sales and decrease in supply, resale market conditions should continue to tighten gradually.

In the case of single-family homes, an analysis of the active listings-to-sales ratio by geographic sector

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[3] This rate is set at 70%.

[4] According to the latest Montréal housing market outlook, sales should keep rising and new listings should fall.

[5] While the sales-to-new listings ratio tells us about the rate of sales in relation to the pace of new listings on the resale market, the active listings-to-sales ratio provides information on the level of inventories relative to the rate of sales.

[6] In a sellers' market, sellers have greater negotiating power relative to buyers, and there is usually higher pressure on prices.

[7] In a buyers' market, buyers have greater negotiating power relative to sellers, and there is usually little or lower pressure on prices.

also revealed certain differences. On the Island of Montréal and the South Shore, the single-family home segment favoured sellers even more[8]. In fact, Île-des-Sœurs and the western part[9] of the Island of Montréal had the tightest market conditions in the CMA, both with ratios of four sellers per buyer.[10]

In several sectors of the Island of Montréal, the significant decrease in new listings of single-family houses for sale in the Centris® system, combined with a strong increase in sales, made such homes harder to find for buyers, causing negotiating conditions to be more and more favourable to sellers.

Additionally, still on the Island of Montréal, given the scarcity of available lands[11] and their relatively high prices, few new single-family homes have been built in recent years. A large part of the demand for such houses on the Island of Montréal is therefore automatically directed to the existing home market, causing market conditions to tighten further.

The single-family home market also tightened in Laval, becoming slightly more favourable to sellers. On the North Shore and in Vaudreuil-Soulanges, conditions tightened as well and were on the cusp between a balanced market and a sellers' market.

In these last sectors, the number of existing single-family homes for sale was also on the decline, but to a lesser extent than on the Island of Montréal. The North Shore is also the sector in the CMA where

the most new single-family houses are being built, making such homes slightly less scarce there.

In the condominium segment, while market conditions tightened in all large sectors of the CMA[12], only the Island of Montréal had a balanced market, with conditions in the other sectors favouring buyers.

Some zones stood out, including Le Sud-Ouest (Island of Montréal), Rosemont (Island of Montréal) and Boucherville–Saint-Bruno (South Shore), with ratios of close to seven sellers per buyer. And while conditions did tighten in Laval and the North Shore, these sectors still had the softest markets (about fourteen sellers per buyer). As in previous quarters, the supply of condominiums on the North Shore therefore remained significant.

Low evidence of price growth acceleration

Evidence of price acceleration remained low in the second quarter of 2017. Still, the tightening market conditions observed for the past few quarters continued to support the growth in the average price of existing homes during the period from April to June.

In fact, in the second quarter of 2017, the average Centris® price (adjusted for inflation and seasonal variations) in the Montréal CMA rose by 1.5%, for its strongest increase since the middle of 2016.

Among all market segments, single-family housing was the one that posted the most significant price growth acceleration. In fact, in each of the large sectors of Montréal, the growth in the average price[13] of single-family houses hovered around 8% in the second quarter of 2017, while it did not exceed 3% in the same quarter of 2016. As was mentioned in the previous section, the strong demand, combined with a relatively limited supply of new and existing single-family homes in several sectors of the Montréal metropolitan area, put increasingly strong pressure on prices in this segment.

The price of plexes (with two to five units) in the North Crown[14] also registered a considerable increase, with a gain of 8% in the second quarter. Just like for single-family houses, the growth had not exceeded 3% in the period from April to June 2016.

The situation was different in the condominium segment, where only the North Shore and Vaudreuil-Soulanges sectors showed greater price growth in the second quarter of 2017 than a year earlier. Still, this growth, at 3%, was relatively weaker than for the other housing types.

Finally, while evidence of price growth acceleration on the Montréal existing home market remained low in the second quarter, this indicator will have to be closely monitored over the coming quarters. With the economic outlook remaining favourable to housing demand, it would not be

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[8] Since the second quarter of 2015, single-family home market conditions have been tightening at similar rates in all sectors of the CMA. However, on the Island of Montréal and the South Shore, conditions were tighter to begin with than in Laval, on the North Shore or in Vaudreuil-Soulanges.

[9] More specifically, in the southern portion of the western part of the Island.

[10] In a sellers' market, the ratio is below eight sellers (or active listings) per buyer (or Centris® sale); in a balanced market, the ratio is between eight and ten sellers per buyer and, in a buyers' market, the ratio is above tem sellers per buyer.

[11] Urban densification is another factor that can contribute to the low level of single-family home construction on the Island of Montréal.

[12] Island of Montréal, Laval, North Shore, South Shore and Vaudreuil-Soulanges.

[13] In this case, the price was not adjusted for inflation and seasonal variations.

[14] Laval and North Shore.

surprising for market conditions to tighten gradually and cause, in turn, a faster increase in prices.

Low evidence of overvaluation

In the second quarter of 2017, the growth in economic and demographic fundamentals continued to support the price levels observed on the Montréal housing market. In fact, the HMA continued to detect low evidence of overvaluation. This means that the model did not identify any significant imbalance between real house prices and the price level dictated by housing market fundamentals, such as personal disposable income and population.

A more detailed analysis revealed that most fundamentals were stronger in the second quarter of 2017 than in the previous quarter. The population grew, the five-year fixed mortgage rate[15] decreased (from 2.6% to 1.8%) and real personal disposable income per capita increased (+0.3%).

As for real house prices (adjusted for inflation and seasonal variations), they showed mixed results. On the one hand, the average Centris® price[16] increased (+1.5%) over the previous quarter. On the other hand, Statistics Canada's New Housing Price Index (NHPI)[17] and the Teranet–National Bank House Price Index™ remained relatively stable from one quarter to the next.
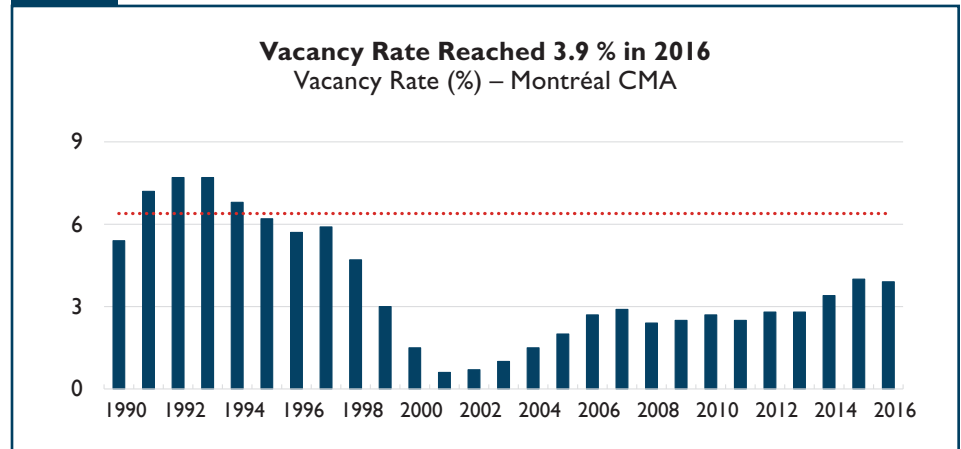
Since 2016, economic conditions in the Montréal area have remained favourable to housing demand. In that sense, even if prices have increased, it was in a context of improving fundamentals[18]. In fact, for the past

Figure 3

Low Evidence of Overbuilding
Completed and Unsold Units per 10,000 Population – Montréal CMA
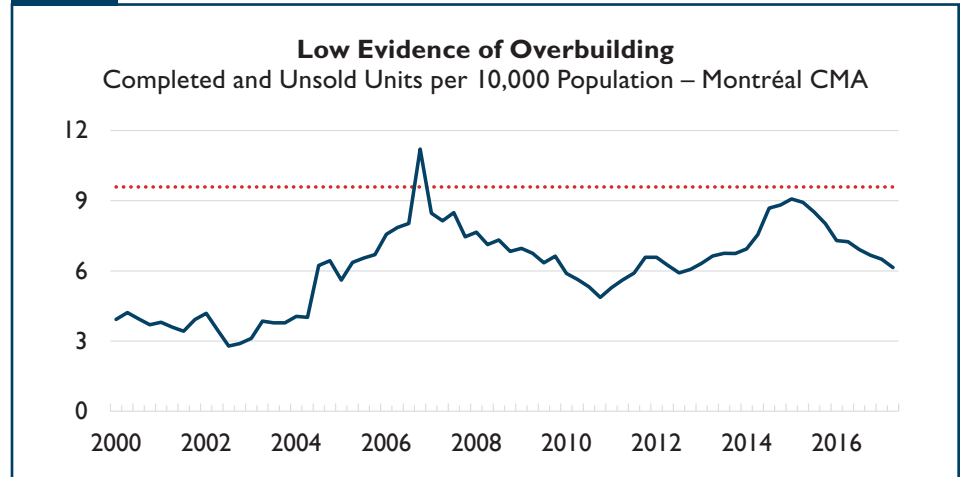
Sources: Statistics Canada and CMHC; Last data point: 2017 Q2.

Figure 4

Vacancy Rate Reached 3.9 % in 2016
Vacancy Rate (%) – Montréal CMA

Source: Source: CMHC; Last data point: October 2016.

three quarters, the overvaluation analysis has shown little difference between real house prices and the prices dictated by the fundamentals.

Low evidence of overbuilding

To assess overbuilding, the analytical framework uses the inventory of completed and unsold units per

10,000 population and the vacancy rate for conventional rental housing as indicators. In the second quarter of 2017, these two indicators showed low evidence of overbuilding (see figures 3 and 4).

In the second quarter, the inventory of completed and unsold units per 10,000 population reached 6.1, well below the rate[19] that would indicate

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[15] Average negotiated rate adjusted for inflation.

[16] Source: Quebec Federation of Real Estate Boards, through the Centris® system.

[17] Source: Statistics Canada.

[18] The presence of foreign buyers in the Montréal CMA does not seem to be a determining factor in the price increase, since it is limited overall.

[19] This rate is 9.6.

an imbalance in homebuilding in Montréal. The inventory of completed and unsold units per 10,000 population in the Montréal area has in fact not been this low since the end of 2012. This low level essentially resulted from the decrease in the inventory of unsold units, combined with an increase in the population. The decline in inventory was due more to the marked slowdown in condominium starts[20], and therefore completions, than to an increase in the absorption rate.

In fact, builders appear to have been selling off unsold new condominiums, instead of starting new projects or new phases, which maintained the number of completions at lower levels in 2015 and 2016. Completions should also stay low in 2017, given that only a small increase in starts is expected for this year.

As well, the vacancy rate remained stable, at 3.9%, according to the results of the Rental Market Survey conducted in October 2016. The increase in net migration allowed rental housing demand to grow at a comparable rate to supply. Evidence of overbuilding is therefore low on this market.

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[20] Condominium starts decreased by 25% in 2015 and by 14% in 2016.

Overview of the Housing Market Assessment analytical framework

To obtain an accurate picture of the overall state of the housing market, it is important to consider multiple data points and lines of evidence rather than relying on just one measure or indicator.

The Housing Market Assessment (HMA) analytical framework provides a comprehensive and integrated view that relies on a combination of signals from several indicators to detect imbalances in housing markets.

Specifically, the framework considers four main factors that may provide an early indication of vulnerability in the housing market: (1) overheating (when demand outpaces supply); (2) sustained acceleration in house prices; (3) overvaluation of house prices in comparison to levels that can be supported by housing market fundamentals (listed below); and, (4) overbuilding (when the inventory of available housing units is elevated).

For each factor, the framework tests for: (1) the incidence of signs of vulnerability, but also considers; (2) the intensity of the signals, i.e. how their magnitude compares with their historical average or how consistent they are with known or suspected house price bubbles, such as for Toronto in the late 1980s and early 1990s; and, (3) the persistence of signals over time.

Generally, a situation in which we detect few signals with low intensity or lack of persistence is associated with a low degree of vulnerability. Conversely, as the intensity, number, and/or persistence of the signals increases, so does the evidence of imbalances in the housing market.

The framework takes into account demographic, economic, and financial determinants of the housing market such as population, personal disposable income, and interest rates to detect vulnerability. The framework also takes into account developments in both resale and residential construction markets.

The framework was developed on the basis of its ability to detect vulnerable housing market conditions in historical data, such as the house price bubble Toronto experienced in the late 1980s and early 1990s. The ability of the HMA to detect vulnerabilities relies on the assumption that historical relationships between prices and fundamental drivers of housing markets have not changed.

Housing Market Assessment Factors

Overheating

Overheating is caused by demand significantly and persistently outpacing the supply of housing. The sales-to-new listings ratio is used as an indicator to assess possible overheating conditions in the existing home market. To identify signs of overheating, the framework compares the sales-to-new listings ratio to thresholds. When demand is strong relative to supply, house prices typically grow at a faster rate. Sustained overheating on the existing home market may lead to acceleration in house prices for existing and new homes. However, as supply and demand begin to balance out, indicators of overheating (and acceleration) would begin to soften and house prices would gradually moderate.

Acceleration in House Prices

Under balanced market conditions, house prices are expected to increase over time, in line with increases in households' cost of living. House price acceleration occurs when the growth in house prices strengthens over time on a persistent basis. Acceleration in house prices over an extended period can cause their pace of increase to depart from the overall price inflation and eventually lead to overvaluation.

To assess acceleration in house prices, the HMA framework uses a statistical test* that was developed to identify periods of accelerating asset prices.

Overvaluation

Overvaluation is detected when house prices remain significantly above the levels warranted by fundamental drivers of housing markets such as income, population, and actual and expected financing costs.

The HMA framework uses combinations of different house price measures and models to estimate house price levels warranted by fundamental drivers.

The difference between observed house prices and their estimated levels consistent with housing market fundamentals allows for an estimation of the degree of over- and undervaluation. The use of different price measures and models improves the reliability of results.

Overbuilding

Overbuilding is detected when the supply of readily available housing units significantly exceeds demand. In such a context, downward pressure on house prices would occur until the excess supply is eventually absorbed. To assess signs of overbuilding in the housing market, the HMA framework uses two indicators that relate to the supply of readily available housing units: the rental vacancy rate, and the inventory of completed and unsold housing units per 10,000 population. The HMA framework compares the current level and recent trends in these indicators with thresholds.

Note 1: Colour codes indicate the degree of market vulnerability. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of imbalances (that is, how far the indicator is from its historical average), but also considers the intensity and the persistence of these signals over time. Generally, low intensity and persistence are associated with a lower vulnerability. As the number of persistent signals increases, the evidence of an imbalance increases.

Note 2: Results at the CMA level are not segmented by housing type or neighbourhood. They represent an assessment of the entire CMA. However, specific CMA reports provide further detailed analysis of these markets.

Note 3: The colour scale extends to red only for those factors that have multiple indicators that can identify imbalances. As a result, only overvaluation and overbuilding can receive a red rating, since they are assessed using more than one indicator.

Note 4: To ensure the framework is as current as possible, on a regular basis, we undertake a model selection process whereby our house price models for overvaluation are tested for statistical significance at the national and CMA level. The result of this process may change the number of indicators showing vulnerability from the previous assessment.

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* See Phillips, Wu and Yu (2008) "Explosive Behaviour in the 1990s NASDAQ When Did Exuberance Escalate Asset Values?" for further details on the methodology.

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