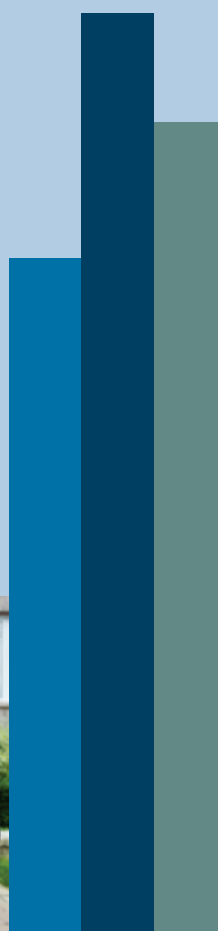


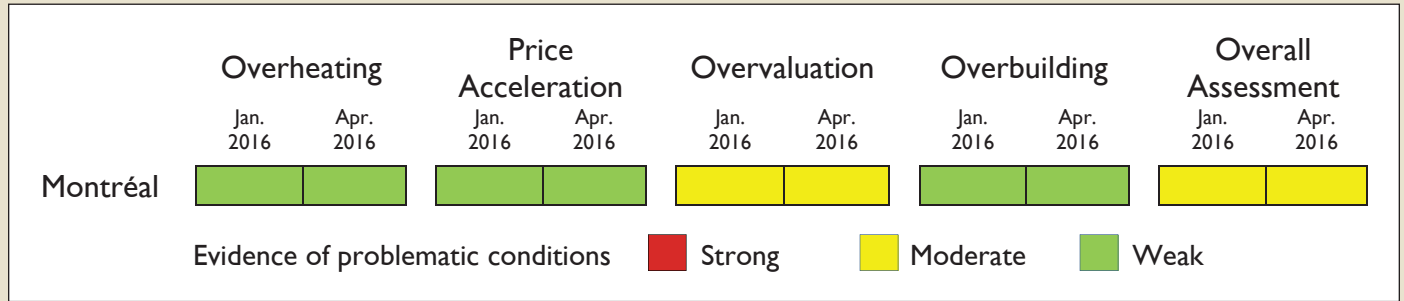
# HOUSING MARKET ASSESSMENT Montréal CMA

Date Released: Second Quarter 2016



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## Highlights



- Overall, on the Montréal CMA market the evidence of problematic conditions was moderate in the fourth quarter of 2015 according to the Housing Market Assessment (HMA) analytical framework.<sup>1</sup>
- On the existing home market, supply remained rather high relative to demand, such that evidence of overheating and acceleration in the growth of prices was weak.
- Based on the analytical framework, moderate evidence of overvaluation persisted on the Montréal CMA market in the fourth quarter of 2015. The price level remained higher than what would have been expected from the fundamentals.
- The evidence of overbuilding has remained weak. The rental vacancy rate and the inventory of completed and unsold units per 10,000 population, have remained below the problematic thresholds.
- The Housing Market Assessment (HMA) analytical framework considers four factors to assess the evidence of problematic housing market conditions: overheating; acceleration in the growth of house prices; overvaluation; and, overbuilding. A brief summary of the framework is presented on page 7 of this report.

## HMA Overview<sup>2</sup>

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 due to supply outpacing demand. Such an imbalance could be resolved by an adjustment in house prices. As an example, lower prices would help resolving an excess supply imbalance by supporting stronger demand and/or reducing

supply. However, other unexpected development 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),

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<sup>1</sup> Results are based on data as of the end of December 2015 and local market intelligence up to end of March 2016. CMHC continuously monitors market developments and will issue HMA updates on a quarterly basis.

<sup>2</sup> A detailed description of the framework is available in the appendix of the [National edition](#).

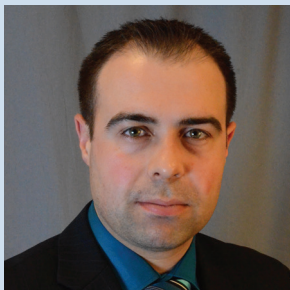
and the persistence over time. Generally, low intensity and persistence are associated with potential weaker evidence of problematic conditions. As the number of intense and persistent signals increases, the associated evidence of problematic conditions becomes stronger.

## In detail

### Weak evidence of overheating

The HMA indicated that the evidence overheating remained weak in the fourth quarter of 2015 on the Montréal CMA market. Supply was still slightly high relative to demand on the existing home market, as evidenced by the sales-to-new listings ratio, which, at 52 per cent, was clearly lower than the problematic threshold

*“The price level remains higher than what would be expected from the market’s fundamentals (economic and demographic). We should specify that the moderate evidence of overvaluation do not reflect a current acceleration in the growth of prices, but rather the fact that fundamentals have not yet caught up with the strong increase in prices observed over the last decade.”*



**Francis Cortellino**  
Principal, Market Analysis

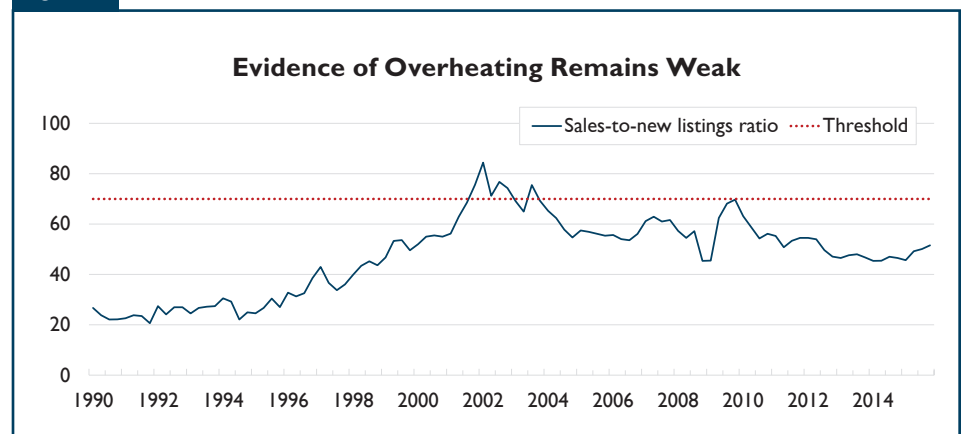
of 70 per cent (see figure 1). From 2011 to 2014, the number of transactions on the existing home market decreased, while the number of new listings rather tended to increase, which resulted in a softer market, as shown by the significant drop in the sales-to-new listings ratio over this period.

In recent quarters, the existing home market posted slightly more strength. The increase in transactions, combined with the new listings, resulted in a slight tightening of

the market toward the end of 2015, a trend that has continued over these past few months in light of the latest data for 2016.

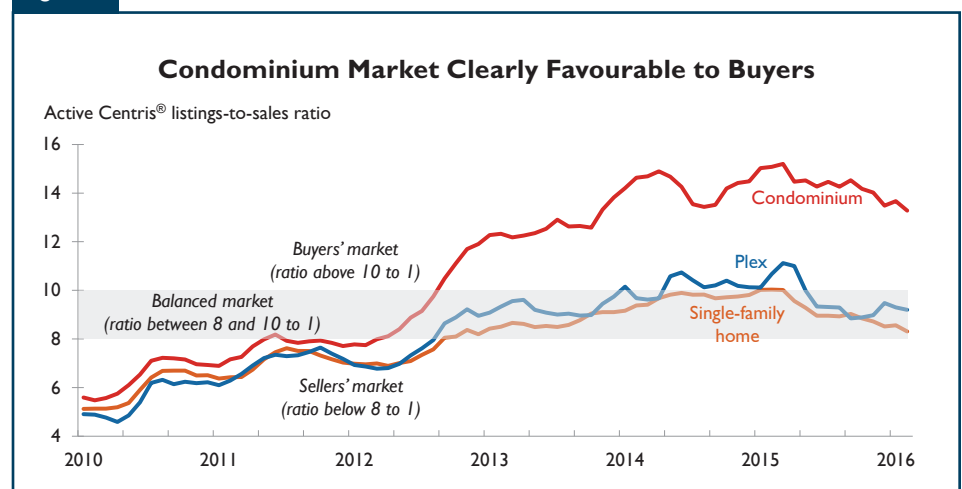
The sales-to-new listings ratio<sup>3</sup> indicated that market conditions varied in the different market segments. In fact, the single-family home and plex (2 to 5 units) segments were balanced, but the condominium segment was clearly favourable to buyers. The analysis of the latest data (figure 2) nevertheless showed that

Figure 1



Source: QFREB by the Centris® system and CMHC calculations  
Last data point: 2015 Q4

Figure 2



Seasonally adjusted data by CMHC, three-month moving average  
Source: QFREB by the Centris® system

<sup>3</sup> This ratio is also used to assess market conditions.

the sales-to-new-listings ratio has decreased over the past few months in all market segments. It should be noted that the single-family housing market is inching toward a sellers' market.

As for the results in the CMA's different geographic sectors, they are rather homogeneous for condominiums, with all large sectors being favourable to buyers. In the single-family housing segment, the Island of Montréal, Laval and South Shore sectors are balanced, while the North Shore and Vaudreuil-Soulanges sectors are favourable to buyers.

### Evidence of acceleration in the growth of house prices remains weak

In view of the large supply relative to demand on the existing home market, the upward price pressure remained weak. Consequently, evidence of acceleration in the growth of prices was also weak, as indicated by the increase of 1.9 per cent in the average price in 2015, which was lower than the increase of 2.2 per cent recorded in 2014.

The growth in the average price in 2015 also reflected a certain composition effect, since sales in the upper price ranges increased much more sharply than in the more affordable price ranges. For example, in 2015, sales of single-family homes over \$400,000 increased by 20 per cent, while those under \$400,000 grew by only 4 per cent. Therefore, despite their rather limited market share,<sup>4</sup> sales of single-family homes over \$400,000 inflated the growth in the Centris® average price in 2015.

The rise in the Teranet–National Bank Price Index™,<sup>5</sup> which does not take into account this composition effect, showed price stability in 2015.

According to our forecasts, market conditions will remain relatively soft in 2016. We therefore do not expect an acceleration in the growth of house prices on Montréal's existing home market during this period.

### Moderate evidence of overvaluation

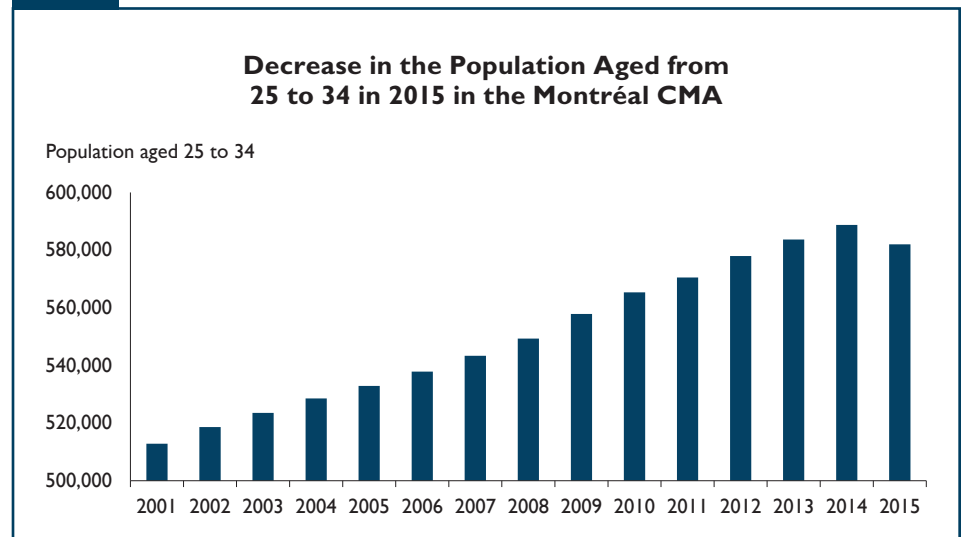
The analytical framework showed that moderate evidence of overvaluation persisted in the Montréal CMA market in the fourth quarter of 2015.

This result indicates that the price level remains higher than what is expected from the economic and demographic fundamentals. We should note that the moderate evidence of overvaluation does not

reflect an acceleration in the growth of prices over the last few quarters. It is rather the result of the significant increase in housing prices that mostly occurred over the last decade and the relative weakness of some fundamentals.

In fact, from 2002 to 2012, the annual growth in the average Centris® price was at least 4 per cent and even reached over 10 per cent in 2002 and 2003. The average price growth outpaced the increase in the personal disposable income per capita during the entire period.<sup>6</sup> The weak rise in demand from first-time buyers over the past few years is another factor that contributed to this result. The population aged from 25 to 34<sup>7</sup> even decreased by 1.2 per cent in 2015, which limited the number of first-time homebuyers on the Montréal market. This demographic group represented a significant share (34 per cent) of homebuyers in 2011.<sup>8</sup>

Figure 3



Source: Statistics Canada, Demography Division, population estimates  
2015: preliminary data

<sup>4</sup> In 2015, sales of single-family homes over \$400,000 accounted for 22 per cent of the transactions for this type of property on the Montréal CMA existing home market.

<sup>5</sup> The Teranet-National Bank National House Price Index™ is based on the repeat sales methodology.

<sup>6</sup> Source: The Conference Board of Canada. Overall, for the period from 2002 to 2012, the average Centris® price more than doubled, while personal disposable income per capita grew by 34 per cent (nominal figures).

<sup>7</sup> Source: Statistics Canada, Demography Division, population estimates.

<sup>8</sup> Source: Statistics Canada, National Household Survey 2011.

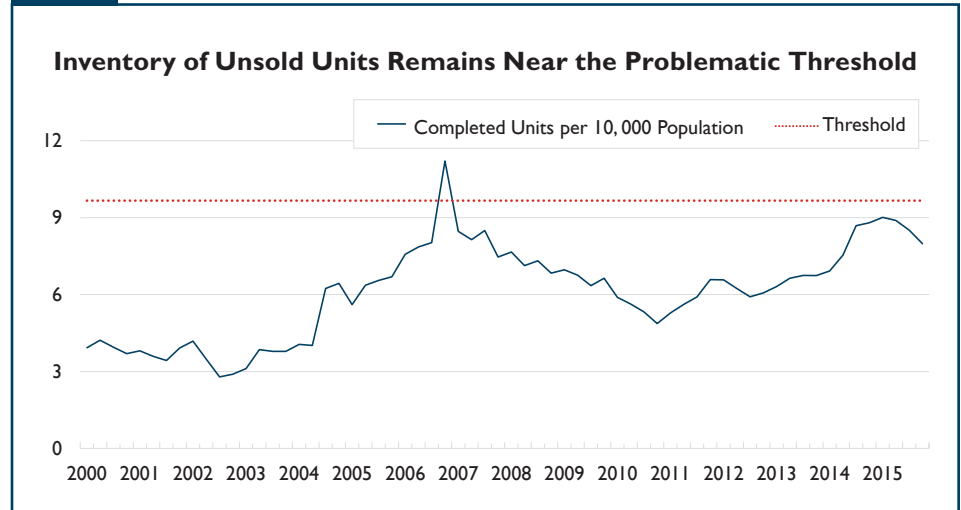
## Evidence of overbuilding remains weak

The two indicators used to assess overbuilding, that is, the inventory of completed and unsold units per 10,000 population and the rental vacancy rate, remained below the problematic thresholds. Therefore, the evidence of overbuilding is weak as detected by the framework

However, the number of completed and unsold units per 10,000 population remains close to the problematic threshold, given the relatively high inventory of unsold condominium units. This market segment recorded a significant volume of housing starts over several years and is in an absorption phase. A little over 2,500 condominium units were completed and unsold at the end of December 2015. In this context, builders greatly reduced condominium housing starts in 2015 and appeared to direct demand toward completed and unsold units or units under construction before launching new projects. Consequently, the inventory of unsold units remained below the problematic threshold.

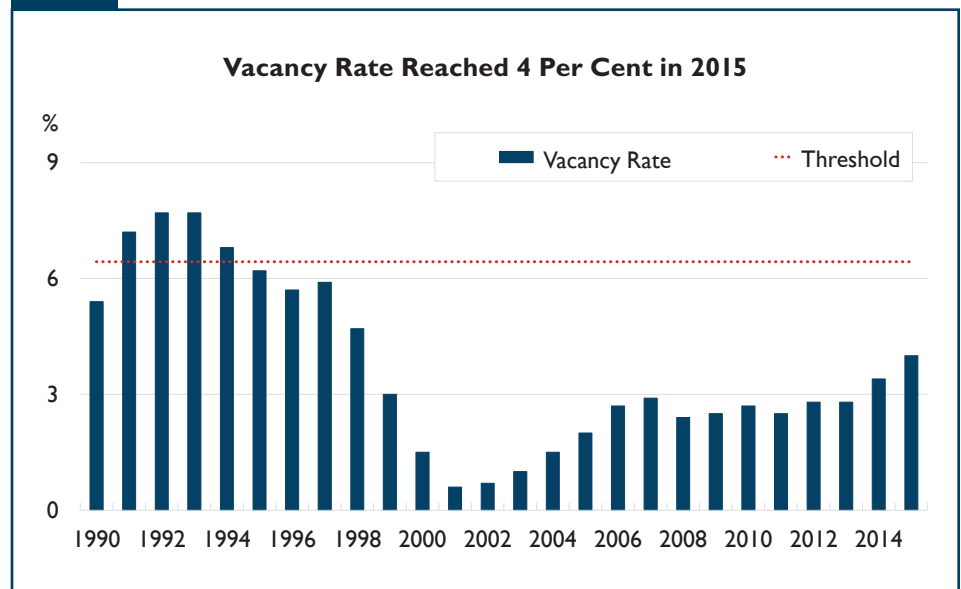
On the rental market, the vacancy rate has increased over the past two years, from 2.8 per cent in 2013 to 4.0 per cent in 2015. With a sluggish condominium market, several builders turned toward the construction of rental housing units. In fact, conventional rental housing starts more than doubled in 2015, which, according to our most recent forecasts, will push the vacancy rate up again in 2016 (see text box).

Figure 4



Source: Statistics Canada and CMHC  
Last data point: 2015 Q4

Figure 5



Source: CMHC  
Last data point: 2015

## Special Topics

As we previously mentioned, the number of conventional rental housing starts was relatively high in 2015 in the Montréal area. Also, according to our most recent forecasts, many rental housing projects should again proceed, which will result in housing starts this year and next.

In such a context, it becomes important to examine if rental housing demand will be able to keep up with supply, because, if not, the vacancy rate would be pushed up closer to the problematic threshold for overbuilding.

Based on our analysis, supply will outstrip demand,<sup>9</sup> for both structural and cyclical reasons. In regard to conditions, the weak net migration forecasted over the

next two years will limit demand for rental units, as will the growing presence of other housing types on the market, such as rental condominiums.

At the structural level, the rise in rental demand will also be limited, first by the small increase in the expected number of young households in the greater Montréal area over the next few years.<sup>10</sup> It should be recalled that these households generally choose to rent.

Second, the expected significant increase in the number of households aged 55 or older might suggest, at first glance, an important rise in rental housing demand, knowing that many of these households are returning to the rental market after owning a home for many years.

However, generally, throughout their lives, fewer of these future senior households were renters than senior households in previous generations. It is therefore possible that, unless there is change in their preferences, they will have a lower propensity to become renters once they have aged—another factor that will limit rental housing demand.

We should add that households aged 75 or older, whose demographic weight will increase considerably over the next few years, will also have the choice of moving into another housing type available on the market, that is, apartments in seniors' residences.<sup>11</sup>

All in all, in light of all these elements, supply should outpace demand on the conventional rental housing market, which will push up the vacancy rate in the Montréal CMA.

<sup>9</sup> According to our latest projections, overall rental housing demand (conventional rental apartments, rental condominiums and apartments in seniors' residences) should increase by about 3,000 renter households per year in 2016 and 2017. During the same period, conventional rental housing starts (excluding rental condominiums and apartments in seniors' residences) should rise by themselves by more than 3,000 units per year. Therefore, conventional rental housing demand should be lower than supply in this market segment over the next two years.

<sup>10</sup> Households whose maintainer is under the age of 35.

<sup>11</sup> According to CMHC's Seniors' Housing Survey, most residents in targeted seniors' housing projects are over the age of 75.



## 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 assess housing market conditions.

Specifically, the framework considers four main factors that may provide an early indication of potentially problematic housing market conditions: (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 presence or incidence of signals of potentially problematic conditions, 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 weak evidence of problematic conditions. Conversely, as the intensity, number, and/or persistence of the signals increases, the likelihood of a factor becoming problematic increases.

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 potentially problematic housing market conditions. 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 problematic 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 current problematic conditions 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 problematic overheating conditions, 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 conditions 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 overbuilding conditions 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 level of evidence of problematic conditions. The HMA reflects a comprehensive framework that not only tests for the presence or incidence of signals of potentially problematic conditions, but also considers the intensity of signals (that is, how far the indicator is from its historical average) and the persistence of signals over time. Generally, low intensity and persistence are associated with a lower potential of upcoming problematic conditions. As the number of persistent signals increases, the evidence of a problematic condition developing 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 signaling significant incidence, intensity and persistence of potentially problematic conditions. 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 of a problematic condition from the previous assessment.

\* 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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