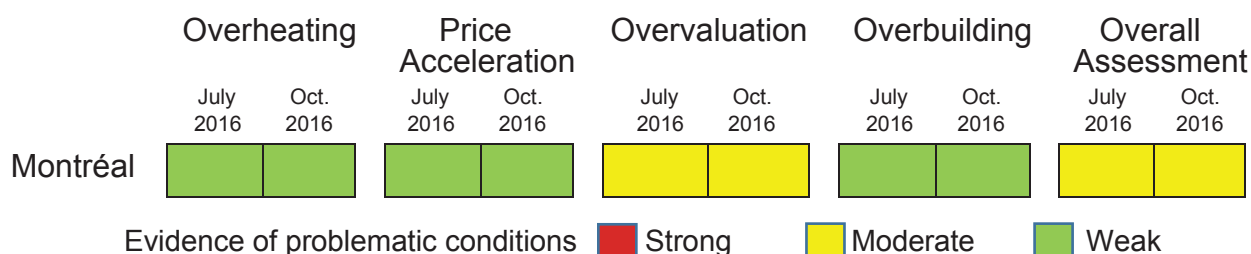# HOUSING MARKET ASSESSMENT
Montréal CMA

Date Released: Fourth Quarter 2016

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Highlights

	Overheating		Price Acceleration		Overvaluation		Overbuilding		Overall Assessment	
	July 2016	Oct. 2016	July 2016	Oct. 2016	July 2016	Oct. 2016	July 2016	Oct. 2016	July 2016	Oct. 2016
Montréal	🟩	🟩	🟩	🟩	🟨	🟨	🟩	🟩	🟨	🟨

Evidence of problematic conditions 🟥 Strong 🟨 Moderate 🟩 Weak

- The Housing Market Assessment (HMA) analytical framework continued to detect moderate evidence of problematic conditions on the Montréal census metropolitan area (CMA) market in the second quarter of 2016[1].

- Evidence of overheating and acceleration in the growth of prices stayed weak, because supply remained rather high relative to demand.

- Moderate evidence of overvaluation continued to be detected, since the level of prices remained above what would be expected from the economic and demographic fundamentals.

- Evidence of overbuilding stayed weak, as the rental housing vacancy rate and the inventory of completed and unsold units per 10,000 population stayed below their respective problematic thresholds.

- The 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.

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.

[1] Results are based on data as of the end of June 2016 and local market intelligence up to end of September 2016. 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.

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.

In Detail

Weak evidence of overheating

In the second quarter of 2016, the signs of overheating remained low in the Montréal CMA's existing home market. In fact, the sales-to-new listings ratio remained at 54 per cent,

which was still clearly lower than the problematic threshold estimated at 70 per cent in the HMA framework (see figure 1).

It should be noted however that, since the second quarter of 2015, the pace of sales has increased, while new listings have decreased; resulting in a slight tightening of the market during this period[3]. According to the active listings-to-sales ratio, another measure of the gap between supply and demand, the Montréal existing home market was balanced overall in the second quarter of 2016. This, after having favoured buyers for the past three years.

However, market conditions differed depending on the market segment. The single-family home and plex segments were on the cusp of a balanced-sellers' market, while the condominium segment remained, for its part, clearly favourable to buyers. Over the next few quarters, given

the increase in sales and the decrease in supply, the market is bound to continue to gradually tighten.

An analysis by geographic sector also revealed that market conditions differed from one sector of the CMA to the next in the second quarter. On the Island of Montréal and the South Shore, the single-family home segment was already slightly favouring sellers[4]. Market conditions in the single-family home segment were softer however in Laval (balanced market) and the North Shore and Vaudreuil-Soulanges sectors (on the cusp of a balanced and buyers' market)

In the condominium segment, the market remained favourable to buyers on both the Island and the suburbs. The surplus was more significant, however, in the suburb areas, especially in the northern crown (Laval and North Shore).

"In the second quarter of 2016, the HMA framework still detected moderate evidence of overvaluation. As a result, house prices remained at a higher level than would be expected from the economic and demographic fundamentals."

David A L'Heureux
Principal, Market Analysis (Montréal)

Figure 1

**Evidence of Overheating Remains Weak
Sales-to-New- Listings Ratio (%) - Montreal CMA**
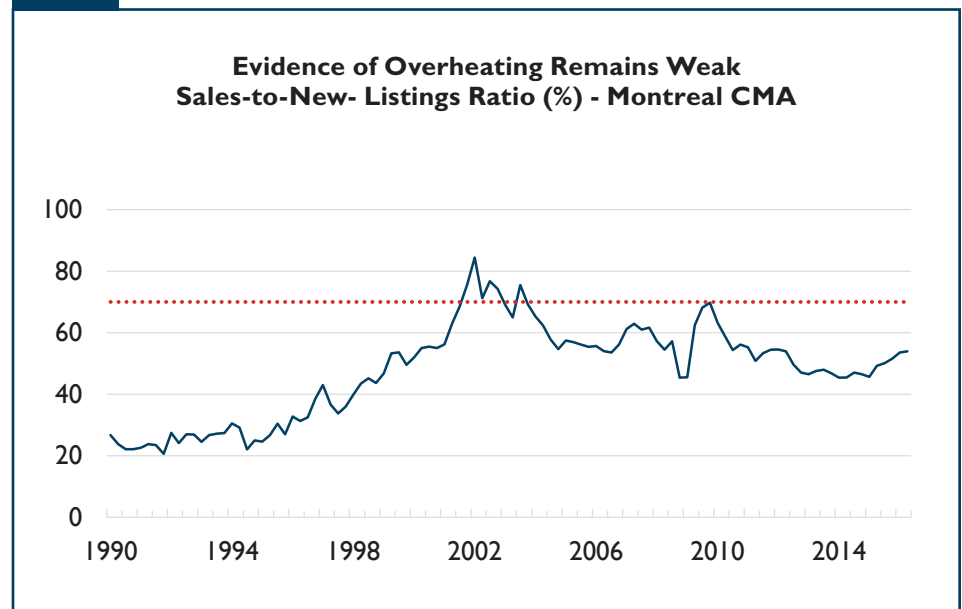
Source : QFREB by the Centris® system   Last data point : 2016 Q2

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[3] The sales-to-new listings ratio has been increasing gradually since the second quarter of 2015. It stood at 45 per cent in the first quarter of 2015.

[4] The single-family home segment is tightening at a similar pace since the second quarter of 2015 in all the sectors of the CMA. However, the Island of Montréal and South Shore sectors were tighter at the start than the Laval, North Shore and Vaudreuil-Soulanges sectors.

Weak evidence of price growth acceleration

In a context where the existing home market has remained rather soft, pressure on prices was modest and there was no indication of price acceleration in the Montréal CMA, according to the HMA. In the second quarter of 2016, the average Centris® price of existing homes rose slightly faster (year over year[5]) than in the first quarter (2.2 per cent compared to 1.8 per cent).

It should be noted that the increase was slightly higher in the second quarter in all market segments. However, it was more significant in the single-family home segment (2.4 per cent year over year versus 1.8 per cent for the plex and condominium segments). This result was attributable to somewhat tighter conditions in the single-family housing market (refer to the previous section on overheating).

According to the Teranet–National Bank House Price Index[6], an indicator that takes into account composition effects, a slight growth in prices (0.5 per cent) was recorded in June 2016 compared to June 2015 in the Montréal area. The growth was somewhat faster than at the end of the first quarter of 2016 (+0 per cent). This reflected the remaining wide gap between supply and demand on the market, as explained in the previous section.

The various price measures indicated a pace of growth only slightly greater than in the first quarter of 2016. In short, while the market is tightening gradually, evidence of price growth acceleration on the Montréal existing home market remained weak.
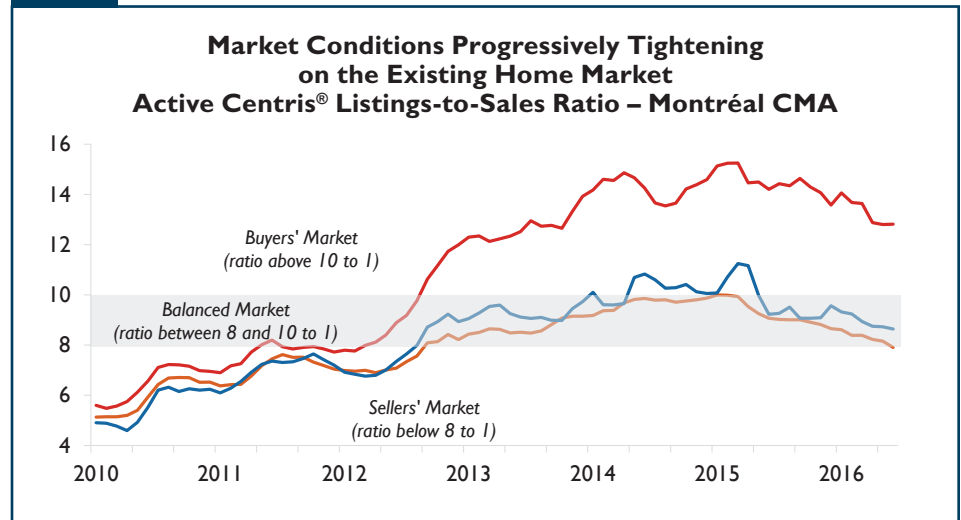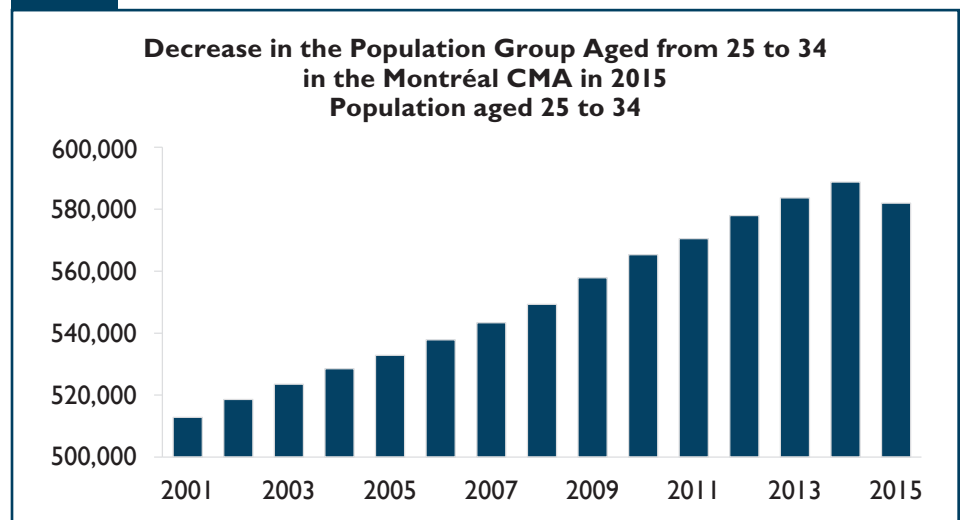
Figure 2

Market Conditions Progressively Tightening on the Existing Home Market
Active Centris® Listings-to-Sales Ratio – Montréal CMA

Sources: QFREB and CMHC calculations
Last data point: June 2016

Figure 3

Decrease in the Population Group Aged from 25 to 34 in the Montréal CMA in 2015
Population aged 25 to 34

Source: Statistics Canada, Demography Division, Population Estimates.

Moderate evidence of overvaluation

In the second quarter of 2016, the HMA framework still detected moderate evidence of overvaluation in the Montréal CMA housing market.

As a result, house prices remained at a higher level than would be expected from the economic and demographic fundamentals.

This result is attributable to the high price increase observed in the 2000s (from 2002 to 2011) and the recent weakness of some fundamentals

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[5] Average price for the last 12 months.

[6] The Teranet–National Bank House Price Index is based on the repeat sales methodology.

Population aged 25 to 34

For one thing, during the 2000s, home prices experienced strong growth, while incomes and the population, for their part, rose more modestly. As a result, the level of prices progressively moved away from what would have been dictated by the economic and demographic fundamentals. This diagnostic was therefore not the result of high housing price growth in the Montréal market over the last few quarters (see the previous section on price growth acceleration).

Also, the slight population decrease of the 25 to 34[7] years' age group and the weak increase in the actual personal disposable income per capita over the last few quarters showed that the price level was higher than what would be expected given the fundamentals.

Still, the more modest growth in prices observed recently helped mitigate the situation. In fact, in the second quarter of 2016, prices progressively moved closer to a level that would be more in line with the various fundamentals.

Finally, given the trends in the prices and the fundamentals, moderate evidence of overvaluation continued to be observed in the Montréal area. Evidence of overvaluation could be corrected by fundamentals outpacing prices or by a decrease in prices.
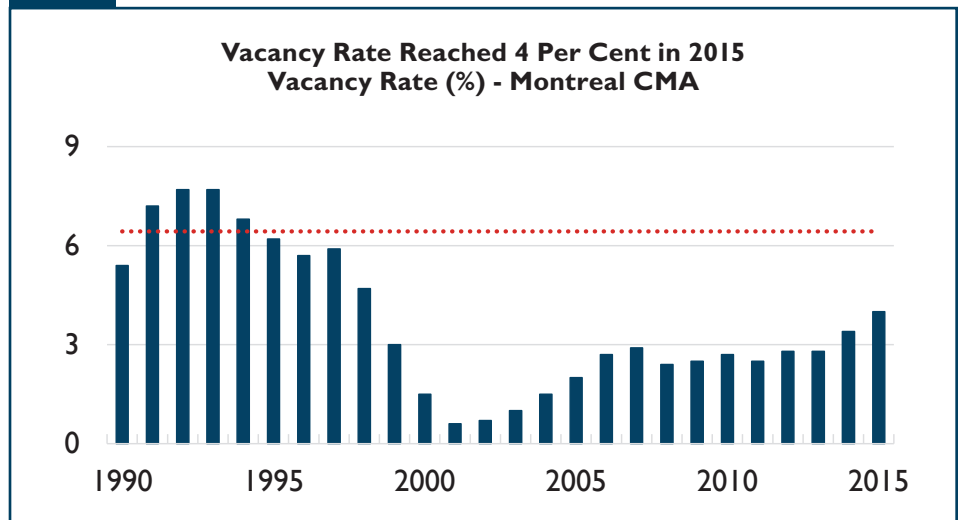
Weak evidence of overbuilding

To assess overbuilding, the analytical framework uses the inventory of completed and unsold units per 10,000 population and the conventional rental housing vacancy rate as indicators. In the second quarter of 2016, these two

Figure 4

Weak Evidence of Overbuilding in the Montréal CMA Completed and Unsold Units per 10,000 Population
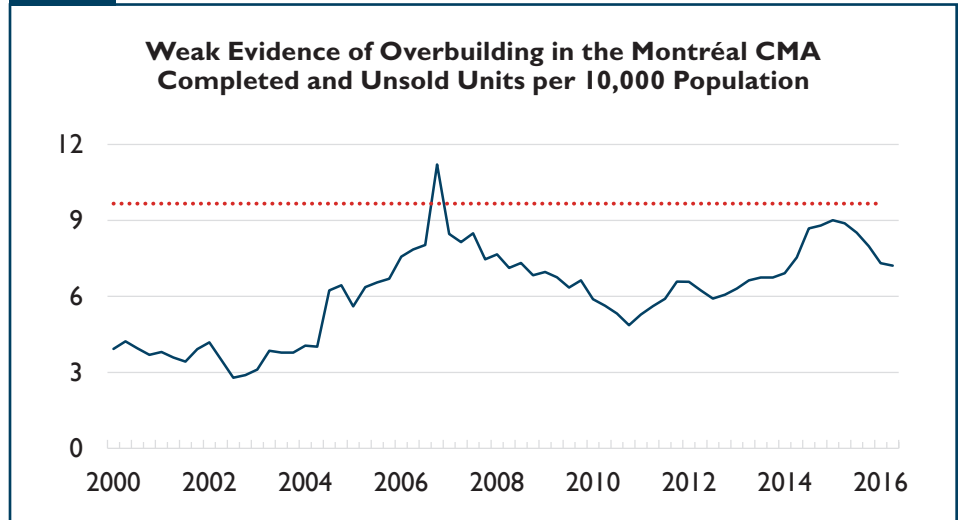
Sources: Statistics Canada and CMHC
Last data point: June 2016

Figure 5

Vacancy Rate Reached 4 Per Cent in 2015 Vacancy Rate (%) - Montreal CMA

Source: CMHC
Last data point: October 2015

indicators were below their respective problematic thresholds. Evidence of overbuilding in the Montréal real estate market therefore remained weak.

For its part, the inventory of completed and unsold units per 10,000 population as of June 2016 remained high, but stable, compared to the previous quarter. This was essentially attributable to the condominium market, which accounted for nearly 80 per cent of all completed and unsold units (2,300 out of 3,000 units).

This stability in the inventory of new unsold condominiums[8] was essentially attributable to the significant

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[7] It should be noted that people aged 25 to 34 accounted for a large proportion (34 per cent) of homebuyers in 2011 according to Statistics Canada's 2011 National Housing Survey.

[8] However, some sectors of the Montréal CMA, such as the North Shore, must still deal with a substantial inventory of unsold new condominiums.

slowdown in condominium starts in 2015 (-25 per cent). Developers appear to have steered demand toward new unsold condominium units instead of starting new projects (or new phases). As proof, the inventory of new condominium units that were still unsold more than one year after completion was down in June in the Montréal CMA (782 units in June 2016, compared to 955 units in March 2016).

Also, the number of units currently under construction was trending downward as of June 2016. This decrease was concealing very different geographic realities however.

In downtown Montréal, the number of units under construction is currently at a very high historical level (3,600 units). This was attributable to the numerous housing starts in years past, especially in 2013, when several large high-rises were started in the span of a few months in the heart of the city.

Once all these units completed, we will have to pay close attention to the impact that they could have on the various real estate market segments of downtown Montréal.

For example, we could observe a significant increase in the number of condominium units for sale on the existing and new home[9] markets or in the supply of condominium units for rent. All these scenarios would cause the gap between supply and demand on the market to widen further.

In the remainder of the CMA (excluding downtown), 5,800 housing units were under construction in June 2016, half as much as the peak reached in 2012, a sign that the new condominium market is truly in an adjustment phase.

As for the rental housing vacancy rate, this indicator did not change from the previous quarter, as this measure is taken only once a year. The last time was in October 2015. In fact, according to the latest forecasts, the vacancy rate should remain stable[10] this year at 4.0 per cent, which is below the problematic threshold.

Despite this stability, a segment of the rental market should still be monitored however. In fact, despite good rental performance, the newer rental housing segment[11] concealed different results.

In newer high-end two-bedroom units (rents above $1,500), the vacancy rate reached 7.0 per cent, which is much higher than the vacancy rate (2.3 per cent) for units in the lower price range (rents below $1,500). Given that the construction of conventional rental projects should stay strong until 2018[12], if several of these projects were in the high-end segment, this market niche could end up with significant excess supply.

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[9] Some new units could remain unsold once the work is completed.
[10] See the Housing Market Outlook report for the Montréal CMA, fall 2016 issue.
[11] Units built in 2005 or later.
[12] See the Housing Market Outlook report for the Montréal CMA, fall 2016 issue.

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.

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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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