

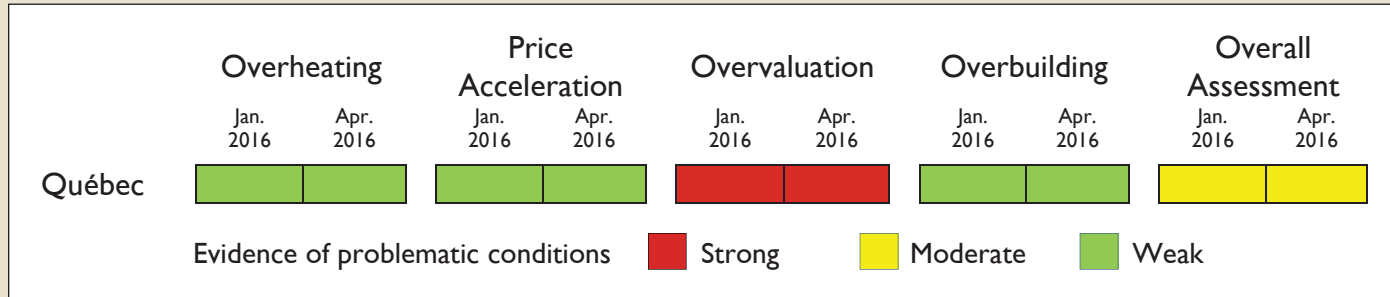
HOUSING MARKET ASSESSMENT Québec CMA

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Highlights



- The Housing Market Assessment (HMA) analytical framework revealed no change from the previous quarter, showing moderate evidence of problematic conditions for the Québec census metropolitan area (CMA).¹
- Strong evidence of overvaluation remained the major highlight for the Québec CMA. These results were due to the recent shrinkage of the pool of first-time homebuyers (aged from 25 to 34) and the modest increase in disposable income per capita.
- As for the other components of the analytical framework, they indicated weak evidence of problematic conditions.
- However, two market indicators are drawing attention: the continued significant supply of condominiums and the considerable number of traditional rental housing units recently started.
- 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 6 of this report.

HMA Overview²

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), 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.

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¹ 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.

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

In Detail

Overheating

The analytical framework indicated that evidence of overheating in the Québec CMA remained weak in the last quarter of 2015. With the sales-to-new listings ratio (SNLR) having reached 45 per cent, the supply of properties exceeded demand on the resale market. The threshold from which evidence of problematic overheating is detected is 70 per cent.

However, the overall SNLR masked underlying differences among the various market segments. An analysis

“In the Québec CMA, the analysis framework revealed strong evidence of overvaluation. This result was due to the recent shrinkage of the pool of first-time homebuyers (aged from 25 to 34) and a rather modest increase in household disposable income. As well, there are still concerns with regard to the supply of condominiums that remains particularly significant on the resale market. Also, recent developments require monitoring for the potential emergence of evidence of overbuilding in the Québec CMA, given the large number of traditional rental housing units under construction.”

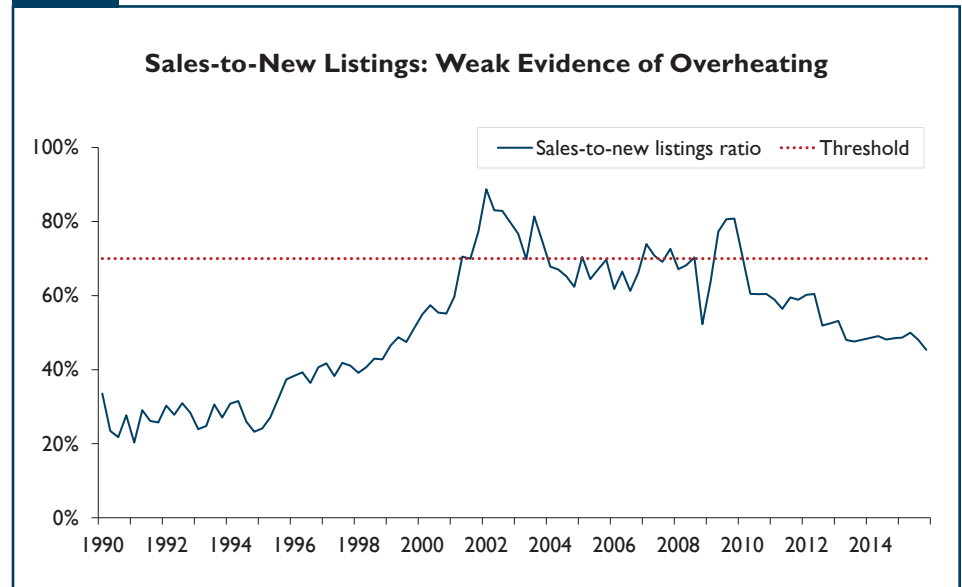


Élisabeth Koulouris
Principal, Market Analysis

of the active Centris® listings-to-sales ratio revealed that market conditions are more favourable to buyers in the case of condominiums than for single-family houses and plexes (figure 2). In fact, the supply of condominiums has significantly exceeded demand since 2013. As well, market conditions favour buyers in all sectors of the CMA.

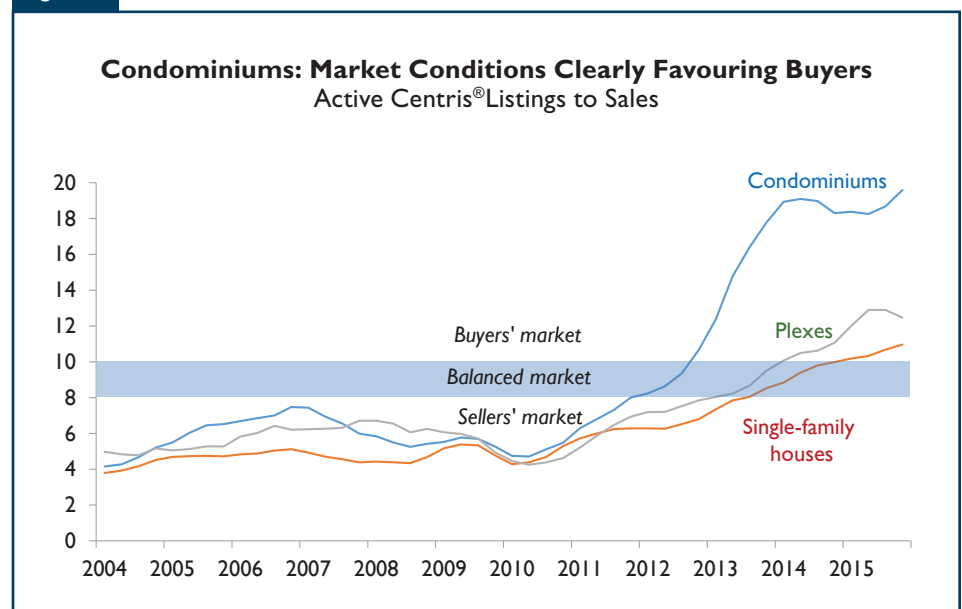
In the case of single-family houses, market conditions have been favouring buyers for only a short while, and sellers still have the edge in some sectors, namely, Val-Bélair/L’Ancienne-Lorette, Charlesbourg, Les Rivières and the Basse-Ville.

Figure 1



Sources: Quebec Federation of Real Estate Boards (QFREB) and CMHC calculations
Last data point: Fourth quarter 2015

Figure 2



Source: QFREB by the Centris® system, four-quarter moving average

Acceleration in the growth of prices

According to the analytical framework, evidence of price acceleration in the CMA remained weak in the last quarter of 2015. Such evidence has been weak since the end of 2013, reflecting the softer market conditions. This led to small price increases, and even a decrease in the average Centris® price of residential properties in 2014 (-1.0 per cent).

Between 2014 and 2015, the median Centris® price of condominiums decreased (-1 per cent), as a result of the abundant supply on the resale market. As for single-family houses, which account for 70 per cent of transactions, their median price increased by just 1 per cent between 2014 and 2015.

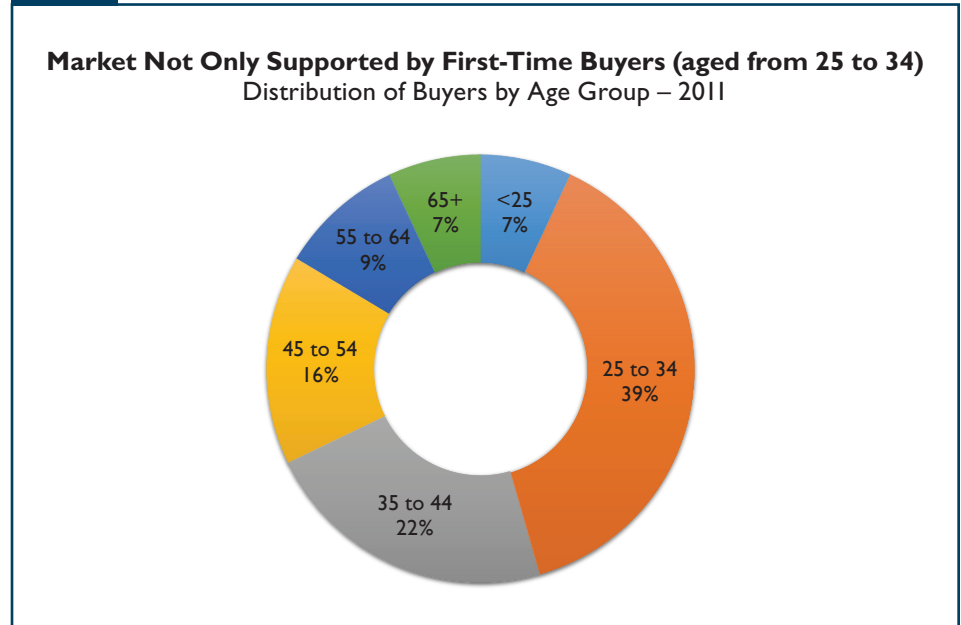
Overvaluation

The analysis update revealed strong evidence of overvaluation in the Québec CMA for the last three months of 2015.

It should be noted that the evidence of overvaluation does not reflect an acceleration in the growth of prices in recent quarters (see previous section). These results indicate that the level of prices exceeded expectations, given the changing economic and demographic fundamentals.

In fact, for the period from 2002 to 2012, the average Centris® price more than doubled, while disposable income per capita grew by 55 per cent. In addition to these trends, the population aged from 25 to 34 began to decrease in 2015.³ It was therefore the weaker demand among first-time homebuyers that contributed to the emergence of strong evidence of problematic conditions with respect to overvaluation.

Figure 3

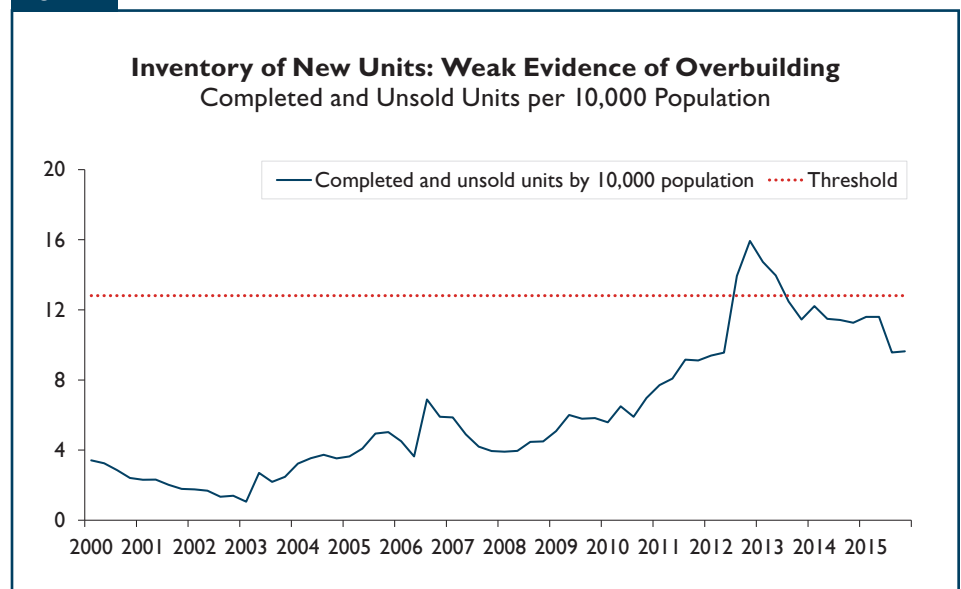


Source: Statistics Canada, Census, special compilation

It should be mentioned, though, that the market is not only supported by young buyers: in 2011, at the time of the last census, first-time buyers (aged from 25 to 34) represented 39 per cent of buyers (figure 4).

Repeat buyers aged from 35 to 64, for their part, accounted for 47 per cent of the market. As well, the aging of the population will lead to the presence of a larger proportion of repeat buyers on

Figure 4



Source: CMHC
Last data point: Fourth quarter 2015

³ Statistics Canada, *Annual Demographic Estimates: Subprovincial Areas*, February 1, 2016

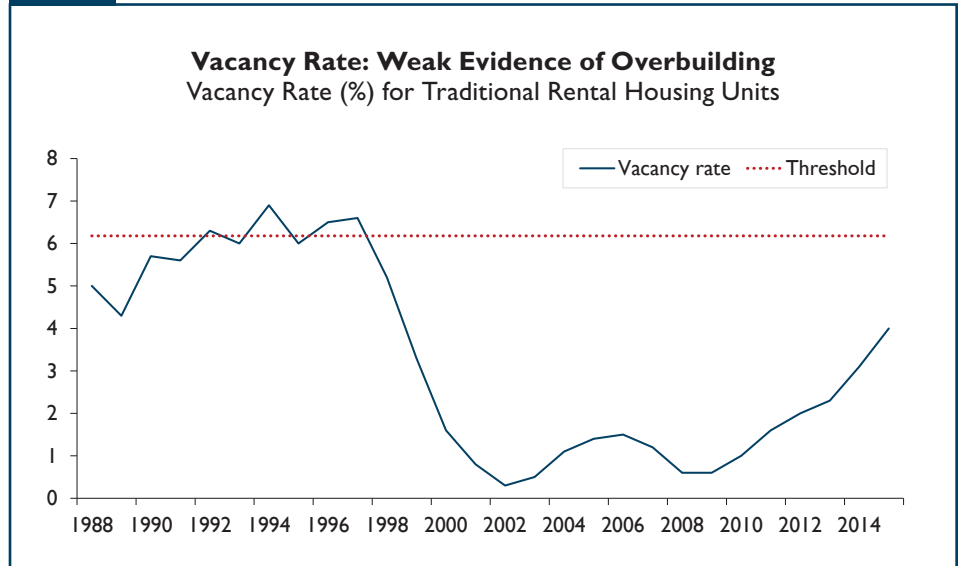
the market. However, it should be noted that recent data revealed weaker overall population growth, contributing to a slowdown in housing demand.

Overbuilding

Evidence of overbuilding was weak in the last quarter of 2015. After reaching a peak at the end of 2012, the inventory of completed and unabsorbed condominiums declined, which brought the evidence of overbuilding to a level below the problematic threshold. The slowdown in housing starts allowed for the absorption of the inventory of recently completed units. However, the supply of condominiums remains relatively significant, and the volumes of starts of such dwellings are expected to be low over the coming years.

But recent developments⁴ require monitoring for the potential emergence of evidence of overbuilding in the Québec CMA, given the large number of traditional rental housing units under construction.

Figure 5



Source: CMHC
Last data point: 2015

In fact, 2,447 traditional rental housing units were started in 2015, compared to 1,184 in 2014. The level of production effectively reached an all-time high last year. The relatively significant inventories of condominiums and the search for new markets in view of maintaining a certain level of activity are among the factors motivating developers who want to build projects that

are often sizable. In addition to the significant activity on the new home market, recent developments on the traditional rental housing market must also be considered. Indeed, as shown by the results of the latest CMHC Rental Market Survey conducted this past October, the vacancy rate is on the rise, having increased from 3.1 per cent in 2014 to 4.0 per cent in 2015.

⁴ See also "Traditional rental market: the growth in supply accelerated in 2015, but what about future demand?" in the first quarter 2016 issue of *Housing Market Insight – Québec CMA*.

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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