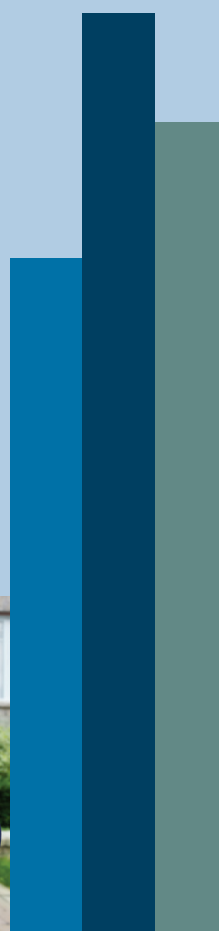


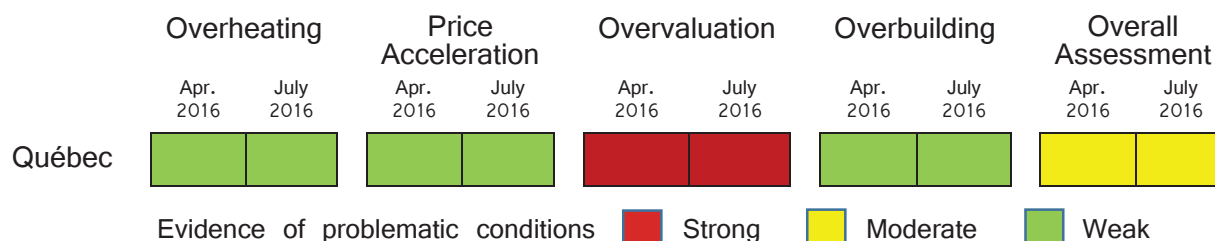
HOUSING MARKET ASSESSMENT Québec CMA

Date Released: Third Quarter 2016



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Highlights



- The results of the Housing Market Assessment (HMA) did not change from the previous quarter, as evidence of problematic conditions remained moderate for the Québec census metropolitan area (CMA).¹
- The Québec CMA market still showed strong evidence of overvaluation. This was due to the modest growth in economic and demographic fundamentals in relation to the increase in home prices.
- The other components of the HMA (overheating, price growth acceleration and overbuilding) indicated weak evidence of problematic conditions.
- However, two market indicators are drawing attention: the continued relatively significant supply of condominiums and the considerable number of traditional rental housing units recently started.
- 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. 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 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.

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¹ Results are based on data as of the end of March 2016 and local market intelligence up to end of June 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 first quarter of 2016. With the sales-to-new listings ratio (SNLR) having reached 50 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 (figure 1).

"In the Québec CMA, the HMA revealed strong evidence of overvaluation. This result was due to the recent decrease in the pool of first-time homebuyers (aged from 25 to 34) and a rather modest increase in household disposable income. As well, the supply of condominiums remained particularly significant on the resale market and continued to raise concerns. Recent developments therefore require monitoring for the potential emergence of evidence of overbuilding in the Québec CMA, given the relatively large number of traditional rental housing units under construction."



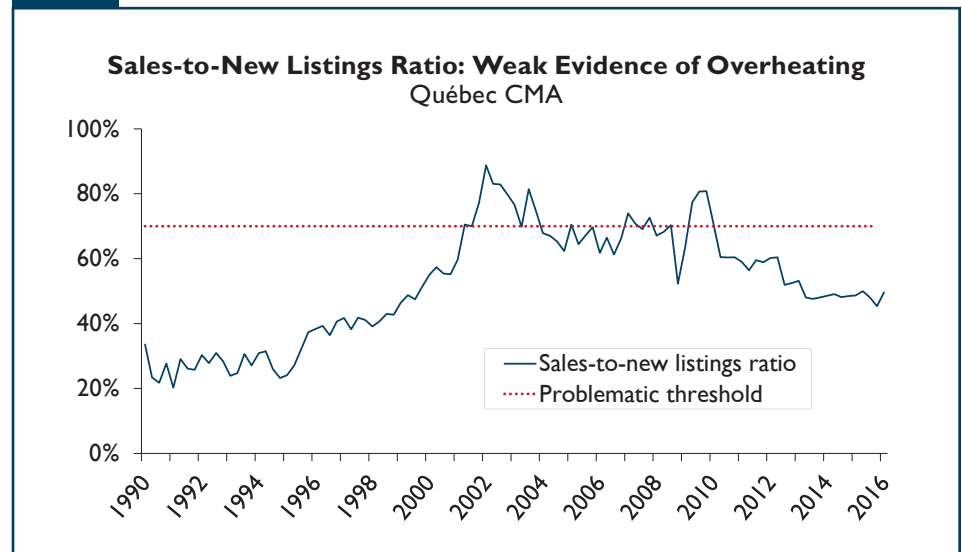
Élisabeth Koulouris
Principal, Market Analysis

However, the overall SNLR masked underlying differences among the various market segments. But another indicator, the active Centris® listings-to-sales ratio, can help us deepen our analysis. This ratio revealed that market conditions were more favourable to buyers in the case of condominiums than for single-family houses and plexes (figure 2), showing that the supply of condominiums significantly

exceeded demand—a situation that has lasted since 2013. As well, market conditions favoured buyers in all sectors of the CMA.

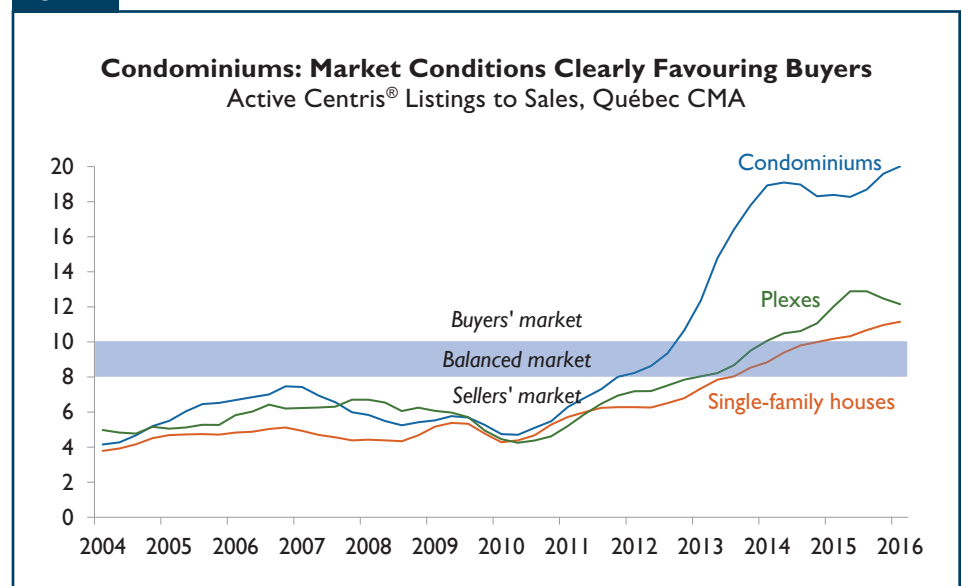
In the case of single-family houses, market conditions have just recently also been favourable to buyers, but sellers still had the edge in some sectors, namely, Val-Bélair–L'Ancienne-Lorette, Charlesbourg, Les Rivières and the Basse-Ville.

Figure 1



Sources: Quebec Federation of Real Estate Boards (QFREB) and CMHC calculations
Last data point: First quarter 2016

Figure 2



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

Price Acceleration

According to the analytical framework, evidence of price acceleration in the CMA remained weak in the first quarter of this year, which was not surprising given that the average Centris® price of homes has changed little since 2014.

This result was attributable to the single-family home market, which accounts for 70 per cent of all transactions and for which the median price rose by less than 1 per cent between the first quarter of 2015 and the first quarter of 2016—a trend that has continued over the last few months. However, the dynamics are different on the condominium market, as the median Centris® price for such units has recently been on a downward trend. In fact, for the first five months of the year, the median price of condominiums was down by 5 per cent from the same period last year. This was not surprising, given the abundant supply on the resale market.

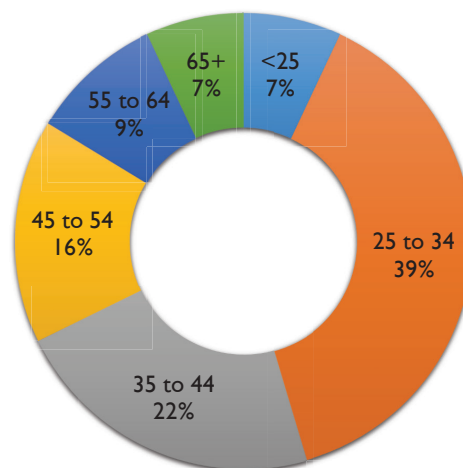
Overvaluation

The latest analysis revealed strong evidence of overvaluation on the Québec CMA market in the first quarter of 2016, just like in the previous quarter.

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) but rather indicates that the increase

Figure 3

First-Time Buyers (aged from 25 to 34) Account for a Significant Share of the Market
Distribution of Buyers by Age Group – 2011, Québec CMA



Source: Statistics Canada, Census, special compilation

in prices was proportionately stronger than the growth in the economic and demographic fundamentals.

To gain a better understanding of this phenomenon, let's take a look at an earlier period: from 2002 to 2012, the average Centris® price more than doubled, while disposable income per capita rose by 55 per cent. This means that prices reached a high level in relation to the economic fundamentals—a situation that has continued since 2012. In addition to these trends, the population aged from 25 to 34 began to decrease in 2015.³ Given that the people in this age group—first-time homebuyers—

represent nearly two in five buyers⁴ on the Québec CMA market (figure 3), the weaker demand among this demographic group contributed to the emergence of strong evidence of problematic conditions due to overvaluation.

Overbuilding

Evidence of overbuilding was weak in the first quarter of 2016. After reaching a peak at the end of 2012, inventories of completed and unabsorbed condominiums declined, such that the evidence of overbuilding fell below the problematic threshold

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

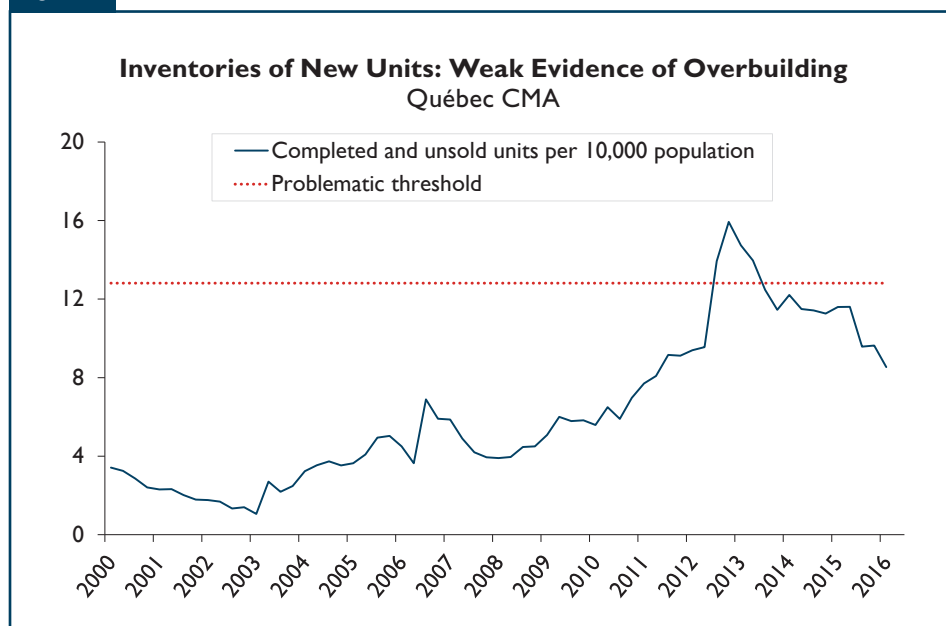
⁴ Statistics Canada, 2011 Census.

(figure 4). The slowdown in housing starts allowed for the absorption of the inventories of recently completed units. Since the supply of condominiums remains relatively significant, low volumes of starts of this type are expected over the coming years.

But recent developments⁵ require monitoring for the potential emergence of evidence of overbuilding in the Québec CMA, given that the number of traditional rental housing units under construction reached an all-time high last year.

In fact, 2,447 traditional rental housing units were started in 2015, compared to 1,184 in 2014. Although down slightly in the first quarter of 2016, when 275 units were started (versus 438 a year earlier), the pace of construction on the Québec CMA rental market remained high from a historical standpoint. The relatively significant inventories of condominiums and the search for new markets in view of maintaining their levels of activity are among the factors motivating some developers who want to build projects, mostly sizable ones. In addition to the strong 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 in October 2015, the vacancy rate is on the rise, having increased from 3.1 per cent in 2014 to 4.0 per cent in 2015 (figure 5).

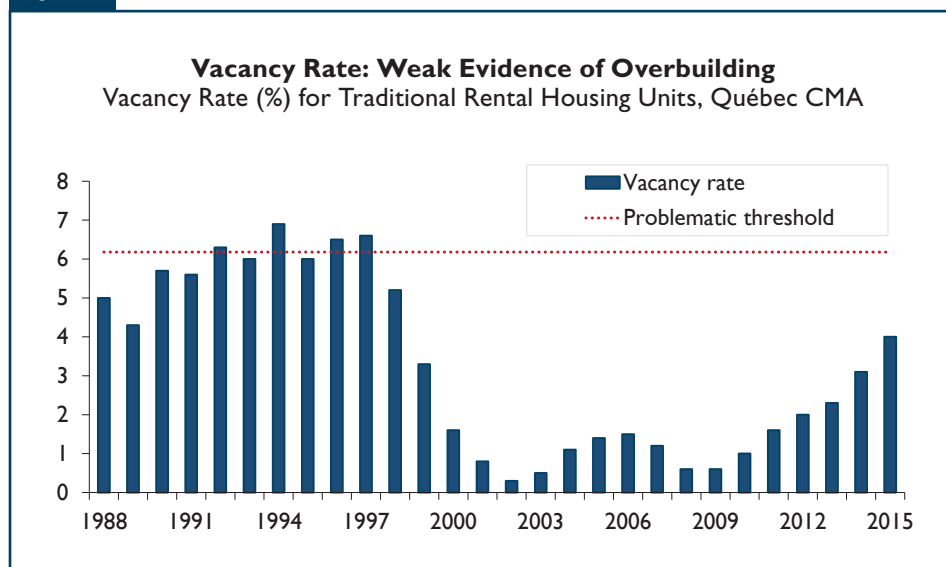
Figure 4



Source: CMHC

Last data point: First quarter 2016

Figure 5



Source: CMHC

Last data point: First quarter 2016

⁵ 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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