

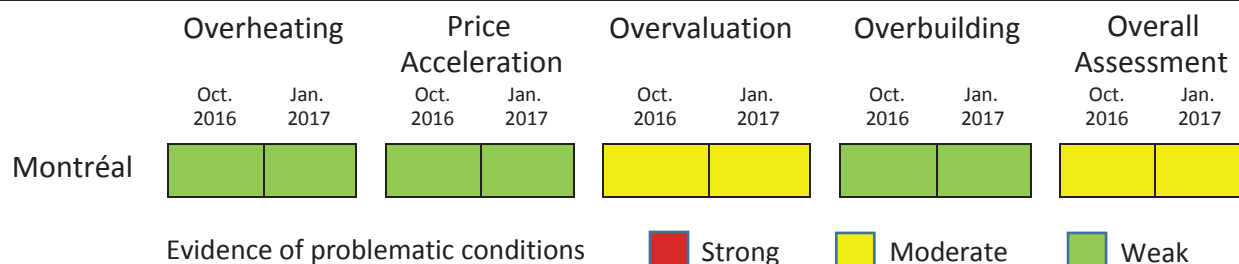
# HOUSING MARKET ASSESSMENT Montréal CMA

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## Highlights



- 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 third quarter of 2016<sup>1</sup>.
- Moderate evidence of overvaluation continued to be detected, since house prices remained above levels warranted by economic and demographic fundamentals.
- Evidence of overheating and acceleration in the growth of prices remained weak. Still, the resale market tightened slightly further, and the growth in prices was somewhat higher than in the previous quarter.
- 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. 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 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.

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<sup>1</sup> Results are based on data as of the end of September 2016 and local market intelligence up to the end of December 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](#).

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 third quarter of 2016, evidence of overheating remained weak in the Montréal CMA existing home market. In fact, the sales-to-new listings ratio

was clearly below the problematic threshold, estimated at 70 per cent in the HMA framework (see figure 1). Still, this ratio was once again on the rise compared to the previous quarter, which reflects a tightening resale market.

Based on the active listings-to-sales ratio<sup>3</sup>, the Montréal resale market was balanced, overall, in the third quarter of 2016 and also showed weak evidence of overheating.

Although evidence of overheating remained weak, analysis of the active listings-to-sales ratio by market segment did reveal certain differences. The single-family home segment slightly favoured sellers<sup>4</sup>, while the plex segment remained on the fence between a balanced and a sellers' market. The conditions in these two segments were therefore

somewhat tighter than on the condominium market, which heavily favoured buyers<sup>5</sup>. Over the next few quarters, given the expected increase in sales and decrease in supply, market conditions could continue to tighten gradually.

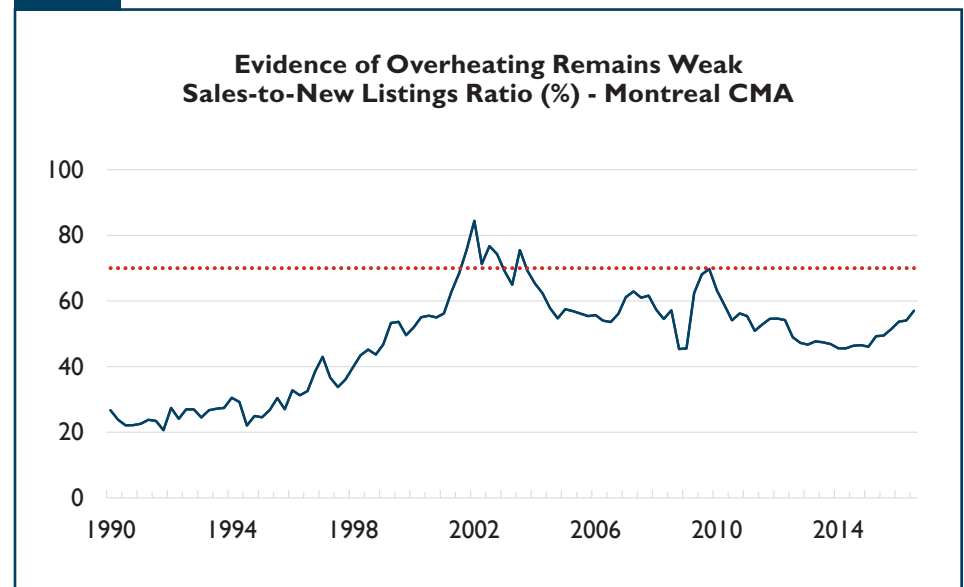
Analysis of the active listings-to-sales ratio by geographic sector also revealed certain differences. On the Island of Montréal and the South Shore, the single-family home segment was slightly favouring sellers<sup>6</sup>. Market conditions in the single-family home segment were softer, however, in Laval (balanced market) and the North Shore and Vaudreuil-Soulanges sectors (on the fence between a balanced and a buyers' market). In the condominium segment, the market remained favourable to buyers on both the Island of Montréal and in the suburbs. The surplus was more

*"In the third quarter of 2016, our analysis continued to reveal moderate evidence of overvaluation on the Montréal market. As a result, house prices remained above levels warranted by economic and demographic fundamentals."*



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

Figure 1



Sources: Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC Last data point: 2016 Q3

<sup>3</sup> While the sales-to-new listings ratio tells us about sales in relation to the pace of new listings on the resale market, the active listings-to-sales ratio provides information on the status of inventories relative to the rate of sales.

<sup>4</sup> In a sellers' market, sellers have greater negotiating power relative to buyers, and there is usually higher pressure on prices.

<sup>5</sup> In a buyers' market, buyers have greater negotiating power relative to sellers, and there is usually little pressure or a decrease in prices.

<sup>6</sup> Since the second quarter of 2015, market conditions in the single-family home segment have been tightening at similar rates in all sectors of the CMA. However, on the Island of Montréal and the South Shore, conditions were less soft to begin with than in Laval, Vaudreuil-Soulanges and on the North Shore.

significant in the suburban areas, though, especially in the northern crown (Laval and North Shore).

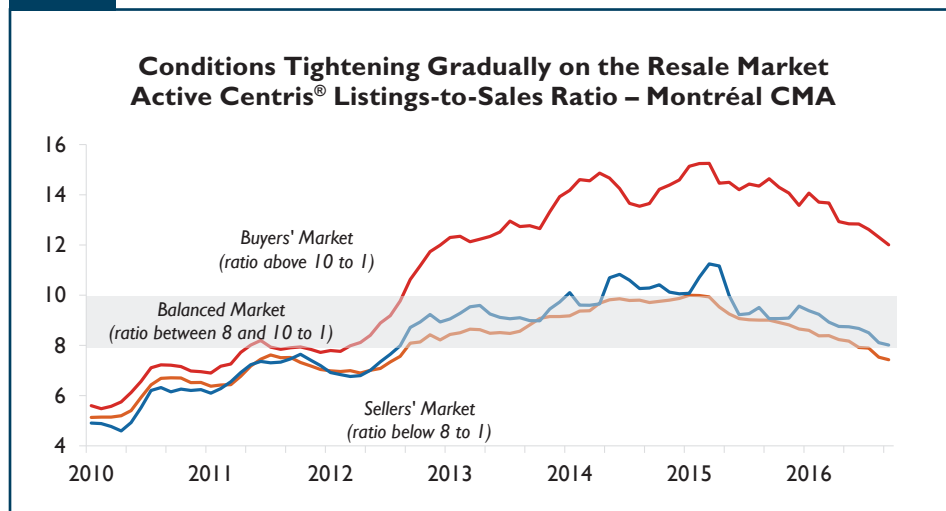
## Weak evidence of price growth acceleration

Evidence of price acceleration remained weak in the third quarter of 2016. That said, the tightening market conditions observed over the last few quarters have resulted in a slightly higher growth rate in the average price on the resale market. In the third quarter of 2016, the average Centris® price<sup>7</sup> of existing homes rose by 2.6 per cent over one year, compared to 2.2 per cent in the previous quarter and to 1.8 per cent in the first quarter. This growth remained below the problematic threshold.

For single-family homes, the increase in the rate of price growth was observed as much on the Island of Montréal as in the suburban sectors. In the condominium segment, however, certain geographic differences were observed. Indeed, it was only on the Island of Montréal that the growth in the average price of condominiums accelerated somewhat. In the suburban areas, market conditions remained much softer, and prices showed very little change. In fact, a slight decrease in the average price of condominiums was even noted in the northern crown.

Additionally, for the CMA as a whole, the plex segment (+3.1 per cent over one year) and the single-family home segment (+2.6 per cent) continued to post slightly higher growth rates than the condominium segment (+2.0 per cent). This result stemmed from the somewhat tighter conditions on the single-family home and plex markets (refer to the previous section on overheating).

Figure 2



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

In short, while the market tightened gradually, evidence of price growth acceleration on the Montréal existing home market remained weak, overall.

## Moderate evidence of overvaluation

In the third quarter of 2016, the HMA framework still detected moderate evidence of overvaluation in the Montréal CMA housing market. As a result, house prices remained above levels warranted by economic and demographic fundamentals.

This result was attributable to the significant growth in prices observed in the 2000s (from 2002 to 2011) and the recent weakness of some fundamentals.

During the 2000s, home prices experienced strong growth, while incomes rose more modestly. Also, the slight decrease in the 25- to 34-year-old segment of the population<sup>8</sup> and the weak increase in the real personal disposable income per capita over the last few quarters resulted in house prices

being above the levels warranted by the fundamentals. This was therefore not the result of strong house price growth in the Montréal market over the last few quarters (see the previous section on price growth acceleration).

In the end, given the trends in the prices and the fundamentals, moderate evidence of overvaluation continued to be observed in the Montréal area.

Our analytical framework does not allow us to determine whether a particular sector of the Montréal area shows greater evidence of overvaluation than another. Therefore, it should not be concluded that the suburban sectors, most of which recorded lower prices than the more central sectors of the Island of Montréal, necessarily showed weaker evidence of overvaluation. The analysis should take into account the prices and fundamentals (incomes, population growth, etc.) particular to each sector.

<sup>7</sup> Weighted average price for the last twelve months.

<sup>8</sup> Note that, according to Statistics Canada's 2011 National Household Survey, 25- to 34-year-olds made up a large proportion (34 per cent) of homebuyers in 2011.

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

Evidence of overvaluation could be corrected by fundamentals outpacing prices or by a decrease in prices.

### Weak evidence of overbuilding

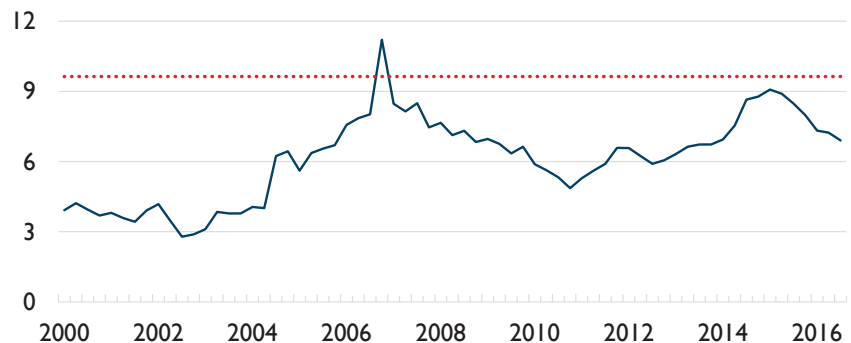
To assess overbuilding, the analytical framework uses the inventory of completed and unsold units per 10,000 population and the conventional rental housing vacancy rate as indicators. In the third quarter of 2016, these two indicators were below their respective problematic thresholds. Evidence of overbuilding in the Montréal real estate market therefore remained weak.

The inventory of completed and unsold units per 10,000 population as of September 2016 was once again down compared to the previous quarter. This decrease was essentially due to the marked slowdown in condominium starts recorded since 2015<sup>9</sup>. Developers therefore appear to have been selling off unsold new condominiums, instead of starting new projects or new phases. As a result, the number of completed and unsold condominiums once again decreased from the previous quarter. There were just over 2,100 completed and unsold condominiums at the end of September 2016, compared to around 2,300 in the previous quarter and 2,551 a year earlier.

As proof, the inventory of new condominium units that were still unsold more than one year after completion was again down in September in the Montréal CMA (724 units in September 2016,

Figure 3

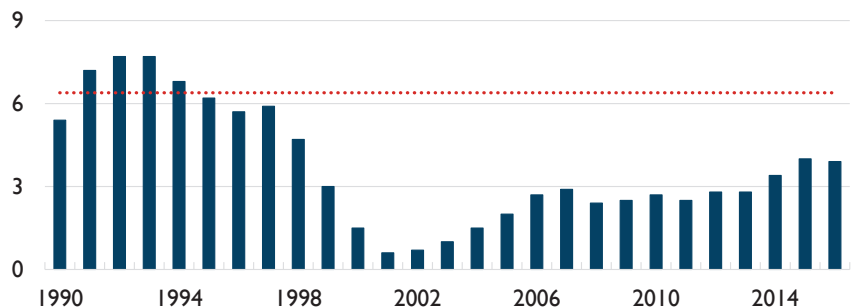
#### Weak Evidence of Overbuilding Completed and Unsold Units per 10,000 Population – Montréal CMA



Sources: Statistics Canada and CMHC  
Last data point: 2016 Q3

Figure 4

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



Source: CMHC  
Last data point: October 2016

compared to 782 in June 2016). This decrease indicates that builders are slowly managing to sell off the remaining unsold condominium units built over the last few years.

### Activity on the condominium market remains strong in downtown Montréal

It should be noted that, while inventories of unsold condominium units under construction are gradually

being absorbed in most sectors of the Montréal CMA, activity remains strong in downtown Montréal.

Indeed, the number of condominium units under construction in downtown Montréal was at a high in September. The more than 4,200 condominium units recorded in that sector represented about 40 per cent of all the condominiums under construction in the Montréal CMA. It should be noted that a large proportion of these

<sup>9</sup> Condominium starts decreased by 25 per cent in 2015 and by 9 per cent over the first three quarters of 2016.

units were concentrated in a few projects of exceptional scale for the Montréal market (projects of 300 units or more). Most of these projects will be completed shortly, and the units will be delivered to their owners.

Once all of these units are completed, we will have to pay close attention to the impact that they could have on the various housing market segments in downtown Montréal. The delivery of these units could mean a surge in the number of condominiums for sale on the existing home market.

In addition, a number of these units will be offered for rent and provide competition for conventional rental apartments. The inventory of completed and unsold condominiums could also increase slightly. In fact, it will take some time for the market in this sector to absorb all of these units. The gap between supply and demand in this sector could well widen in the short term.

As for the vacancy rate, it remained stable, at 3.9 per cent, 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. The vacancy rate therefore remained below the HMA problematic threshold.



## 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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