

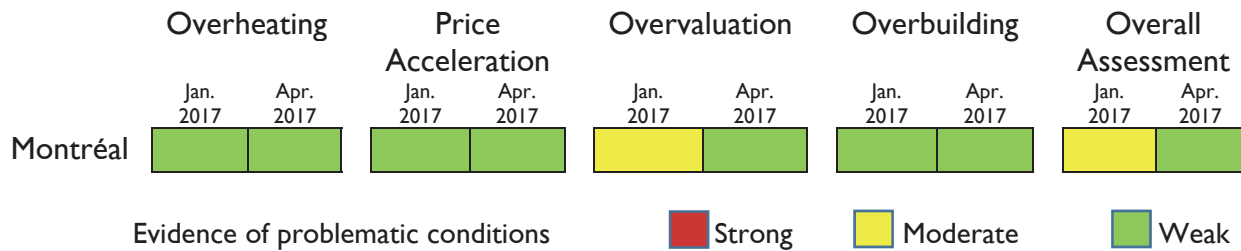
HOUSING MARKET ASSESSMENT Montréal CMA

Date Released: Second Quarter 2017



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Highlights



- In the fourth quarter of 2016¹, the evidence of problematic conditions revealed by the Housing Market Assessment (HMA) analytical framework eased from moderate to weak on the Montréal census metropolitan area (CMA) market.
- This lower overall rating was attributable to decreased evidence of overvaluation.
- Weak evidence of overvaluation was the result of house prices that are closer to levels dictated by the economic and demographic fundamentals.
- Evidence of overheating and acceleration in the growth of prices remained weak. Still, the resale market has recently tightened somewhat.
- Evidence of overbuilding also remained weak. The number of completed and unsold units per 10,000 population continued to decline.
- 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 summary of the framework can be found on page 7.

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

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¹ Results are based on data as of the end of December 2016 and local market intelligence up to end of March 2017. 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 [Second Quarter 2016 National edition](#)

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.

In Detail

Weak evidence of overheating

In the fourth quarter of 2016, evidence of overheating remained weak in the Montréal CMA existing home market. In fact, the seasonally adjusted sales-to-new listings ratio was 59%, which is lower than the problematic threshold, set at 70% in the HMA framework (see figure 1). Still, this ratio was once again on the rise compared to the previous quarter (57%), which indicates a tightening resale market caused by a decrease in new listings coupled with an increase in Centris® sales in the fourth quarter.

A second market indicator, the active listings-to-sales ratio³ suggests that the Montréal resale market

was balanced overall during the fourth quarter of 2016. However, conditions differed for the various types of properties (see figure 2). The single-family home and plex segments slightly favoured sellers⁴. The conditions in these two segments were therefore somewhat tighter than on the condominium market, which heavily favoured buyers⁵. Over the next few quarters, given the expected increase in sales and decrease in supply, market conditions could continue to tighten gradually.

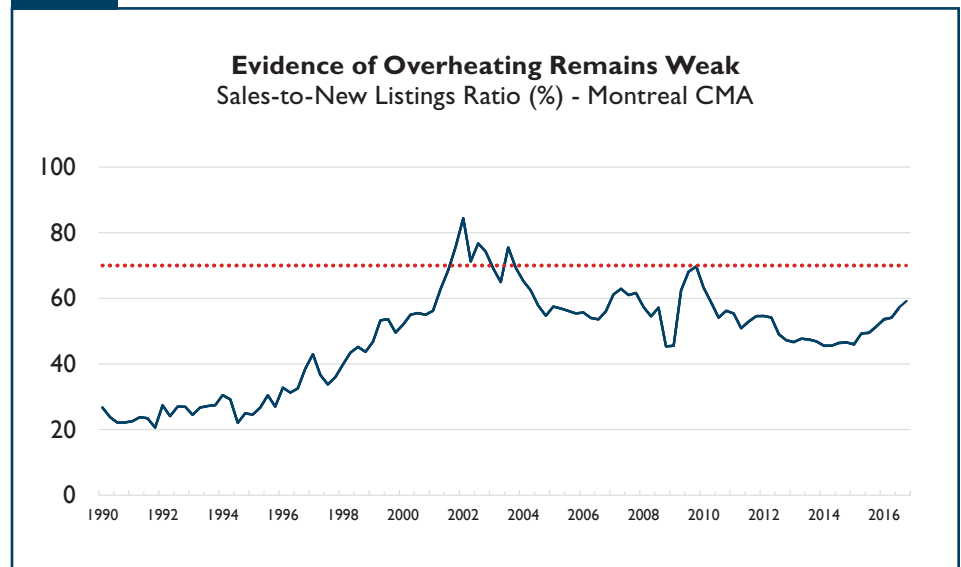
Analysis of the active listings-to-sales ratio by geographic sector also revealed certain differences. On the Island of Montréal and the South Shore, the single-family home segment slightly favoured sellers⁶. More specifically, market conditions were tightest on Île-des-Sœurs, in Le Sud-Ouest, and in the southern portion of the west part of the Island

"In the fourth quarter of 2016, our analysis revealed weak evidence of overvaluation on the Montréal market, a shift from the assessment of moderate evidence made in the third quarter. This decrease in the level of overvaluation is a result of stronger economic and demographic fundamentals"



Marie-Claude Guilloette
Senior Market Analyst

Figure 1



Source: Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC. Last data point: 2016 Q4.

³ 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.

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

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

⁶ Since the second quarter of 2015, the single-family home market has 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.

of Montréal, as well as on the South Shore, in Saint-Hubert, Boucherville and Saint-Bruno.

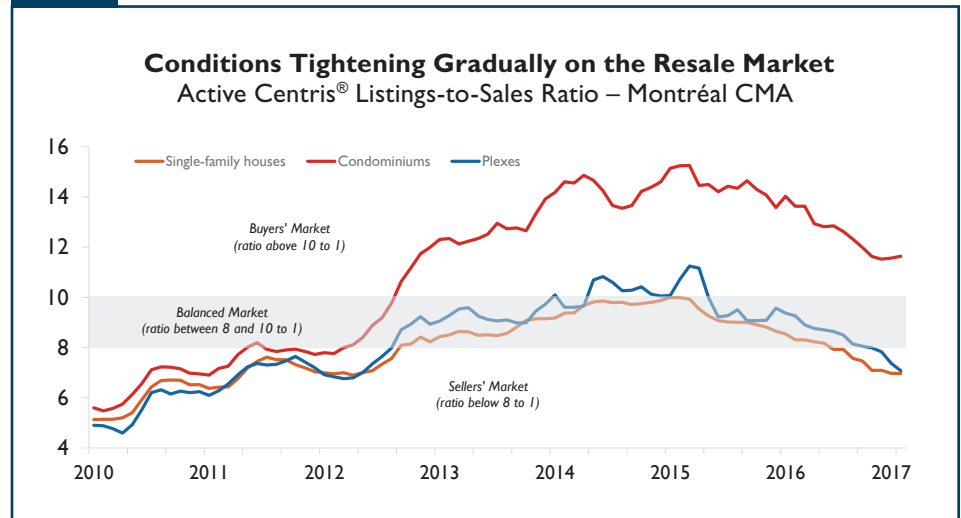
In the northern crown, the single-family home market tightened, becoming a sellers' market in Laval and a balanced market on the North Shore. In Vaudreuil-Soulanges, however, conditions remained softer (on the fence between a balanced and a buyers' market).

In the condominium segment, the market was favourable to buyers both on the Island of Montréal and in the suburbs. The market was particularly soft in Laval and on the North Shore. Certain sectors of the North Shore, in particular, are worthy of special attention. Various municipalities⁷ registered increases in supply on the resale market during the fourth quarter of 2016, while the average prices of condominiums decreased. Condominium housing starts was very strong in 2013 and 2014. This then contributed to an increase in supply on the resale market. Additionally, the inventory of new completed and unsold condominiums was greater on the North Shore than on the Island of Montréal at the end of 2016. In short, condominium buyers on the North Shore enjoyed a wide choice of both the new and existing condominiums.

Weak evidence of price growth acceleration

Evidence of price acceleration remained weak in the fourth quarter of 2016. That said, the tightening market conditions observed over the last few quarters have resulted in slightly higher growth rate in the average price of existing homes.

Figure 2



Source: QFREB and CMHC calculations. Last data point: February 2017

In the fourth quarter of 2016, the average Centris® price⁸ (adjusted for inflation and for seasonal variations) of existing homes rose by 0.5% relative to the third quarter, compared to an increase of 0.2% in the previous quarter. This growth was still below the problematic threshold.

For the CMA as a whole, the average Centris® prices (not seasonally adjusted) of single-family homes and plexes increased by 3.8% and 3.3% year over year, respectively—a slightly quicker pace than that of condominiums (+3.0%). This was the result of tighter conditions on the single-family home and plex markets (see the previous section on overheating).

The increase in the annual rate of price growth did not, however, extend to the entire CMA. Firstly, for the single-family home segment, this situation was only observed on the Island of Montréal (+3.8% year over

year) and the South Shore (+2.7%). On the Island of Montréal, the growth was spurred on by increased activity in the most expensive sectors such as the Centre (including Westmount) and Le Plateau-Mont-Royal.

Secondly, for the condominium segment, the growth in the average price accelerated on the Island of Montréal (+3.0%), in Laval (+2.1%) and in Vaudreuil-Soulanges (+4.7%). However, prices decreased slightly on the South Shore (-0.2%) and on the North Shore (-1.6%). On the North Shore, prices decreased for the fourth consecutive quarter, on account of the abundant supply, mentioned in the previous section.

In short, while the market tightened gradually, evidence of price growth acceleration on the Montréal existing home market remained weak, in general, over all sectors.

⁷ Boisbriand, Sainte-Thérèse, Blainville and Saint-Jérôme.

⁸ Weighted average price for the last 12 months.

Weak evidence of overvaluation

In the fourth quarter of 2016, the HMA revealed weak evidence of overvaluation. This represents a change relative to the third quarter, when evidence of overvaluation was moderate. Weak evidence of overvaluation means that house prices in the Montréal CMA were more in line with levels warranted by fundamental drivers of housing markets such as income, population, and financing costs.

This result was attributable to the fact that nearly all of the fundamentals included in the house price models were stronger in the fourth quarter of 2016 than in the third quarter of the same year, while mixed results were registered for the three housing price indicators.

The fundamentals that contributed to closing the gap with real house prices were growth in the total population (+0.2%) and the number of young adults (25- to 34-year-olds) (+0.2%), a significant decrease in the five-year fixed rate (from 3.2% to 2.9%) and a slight increase in real personal disposable income per capita (+0.1%). The other fundamentals, such as construction costs, stagnated. It should be noted that Statistics Canada revised certain population data upwards⁹, which also contributed to narrowing the gap with real house prices.

For real house prices (adjusted for inflation and seasonal variations), the only price indicator to have increased relative to the third quarter was the average Centris® price (+0.5%). The Teranet–National Bank House Price Index, meanwhile, posted

a decrease (-0.6%), and Statistics Canada's New Housing Price Index (NHPI) remained unchanged.

As a result, the gap between real house prices and the prices supported by the fundamentals was below the problematic threshold for the fourth quarter of 2016, and weak evidence of overvaluation was therefore observed in the Montréal area.

Because socio-economic data are not available by sector, our analysis 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.

Weak evidence of overbuilding

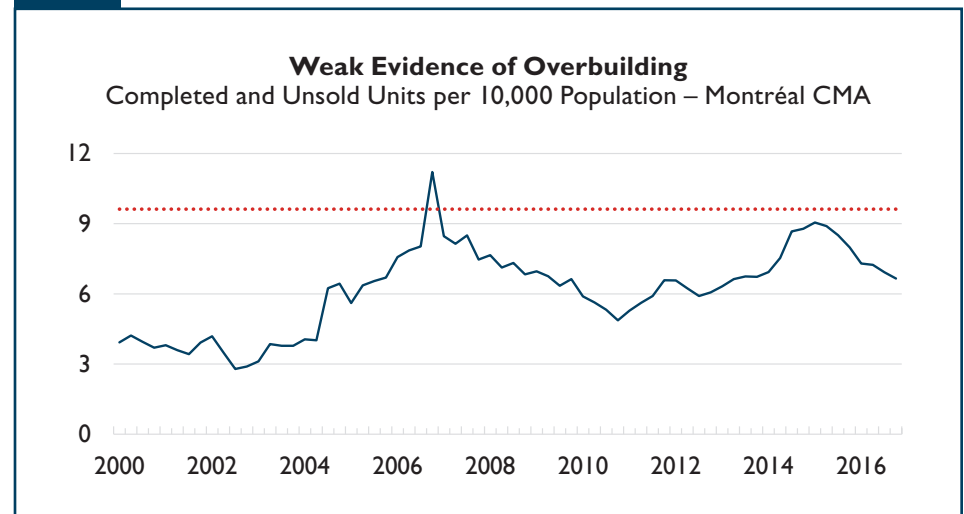
To assess overbuilding, the analytical framework uses the inventory of completed and unsold units per

10,000 population and the vacancy rate for conventional rental housing as indicators. In the fourth quarter of 2016, both of these indicators were below their respective problematic thresholds (see figures 3 and 4). 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 December 2016 was once again down compared to the previous quarter. This decrease was essentially due to the marked slowdown in condominium starts recorded since 2015¹⁰. What's more, in 2016, condominium starts reached their lowest level for a fourth quarter in the last ten years.

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. On average, there were slightly more than 2,100 completed and unsold

Figure 3



Sources: Statistics Canada and CMHC. Last data point: 2016 Q4.

⁹ For example, the population of 25- to 34-year-olds, which showed a decrease in the fourth quarter (-0.2%) before the revision made by Statistics Canada, now posts a gain (+0.2%) for the same quarter.

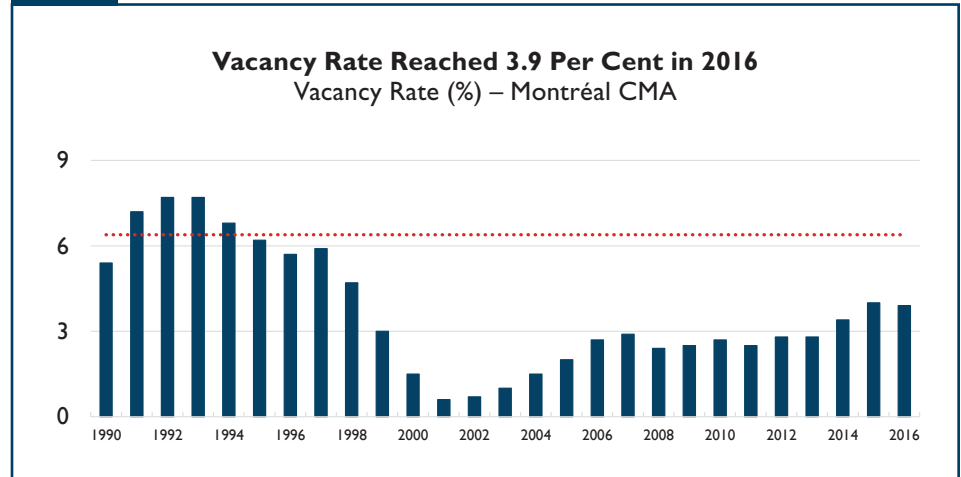
¹⁰ Condominium starts decreased by 25% in 2015 and by 14% in 2016.

condominiums in the fourth quarter of 2016, compared to 2,250 in the previous quarter and 2,550 in the fourth quarter of 2015.

As proof, the inventory of new condominium units that were still unsold more than one year after completion was again down in December in the Montréal CMA (677 units in December 2016, compared to 724 in September 2016). This decrease indicates that builders are slowly managing to sell off the remaining unsold condominium units built over the last few years.

As we mentioned before¹¹, activity on the condominium market remains strong in downtown Montréal. Even though the number of condominiums under construction posted a decrease at the end of 2016, other projects started in the downtown area at the beginning of 2017 will push the number of units under construction back to levels reached in September 2016. This could lead to a slight increase in the inventory of

Figure 4



Source: CMHC. Last data point: October 2016

completed and unsold condominiums over the next few quarters. It should be noted that most of these units have been presold.

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 problematic threshold established for the HMA in regard to overbuilding.

¹¹ See pages 5 and 6 of the HMA report published in the first quarter of 2017 for further details regarding this dynamic that is particular to the downtown area: [Housing Market Assessment—Montréal 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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