

HOUSING MARKET ASSESSMENT

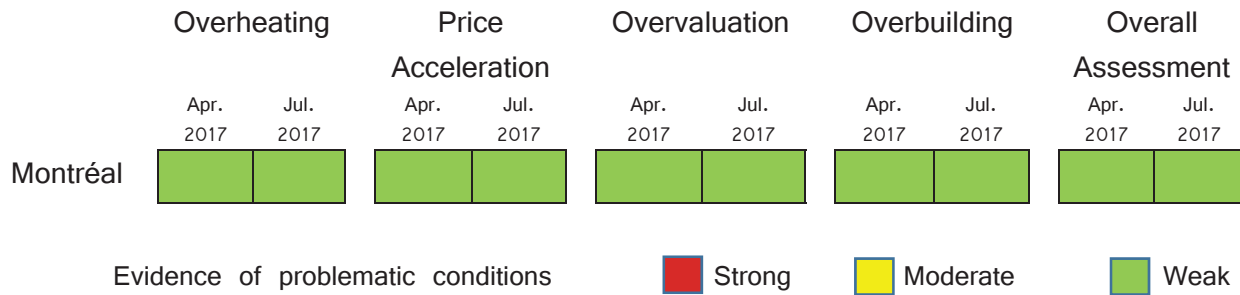
Montréal CMA

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Highlights



- In the first quarter of 2017¹, the evidence of problematic conditions revealed by the Housing Market Assessment (HMA) analytical framework remained weak on the Montréal census metropolitan area (CMA) market.
- Continued weak evidence of overvaluation was the result of house prices remaining 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 continued to tighten.
- 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 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

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¹ Results are based on data as of the end of March 2017 and local market intelligence up to end of June 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](#)

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

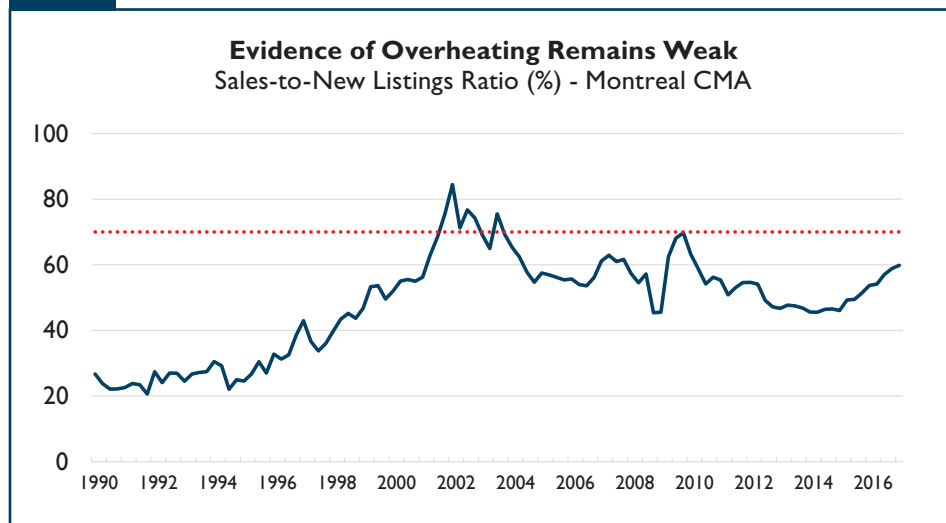
In the first quarter of 2017, evidence of overheating remained weak in the Montréal CMA existing home market. In fact, the seasonally adjusted sales-to-new listings ratio was 60% (see figure 1), which is lower than the problematic threshold, set at 70% in the HMA framework. Still, this ratio was up very slightly compared to the previous quarter (59%), which is in line with a tightening resale market caused by a decrease in new listings coupled with an increase in Centris® sales in the first quarter. Over the upcoming quarters, this ratio should continue to move closer to the problematic threshold if the upward trend in Centris® sales continues,

"In the first quarter of 2017, evidence of problematic conditions remained weak. The resale market continued to tighten, putting upward pressure on prices, but the favourable economic and demographic situation justified current price levels"



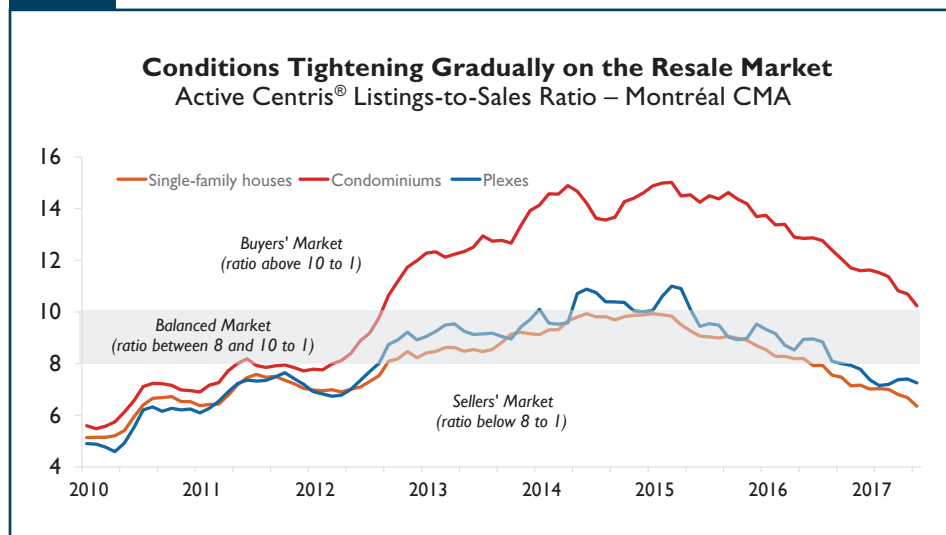
Marie-Claude Guillothe
Senior Market Analyst

Figure 1



Source: Quebec Federation of Real Estate Boards (QFREB) by the Centris® system, seasonally adjusted data by CMHC. Last data point: 2017 Q1.

Figure 2



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

as suggested by the CMA's housing market outlook for the remainder of the year.

A second market indicator, the active listings-to-sales ratio³, suggests that the Montréal resale market was balanced overall during the first

quarter of 2017. However, conditions differed for the various types of properties (see figure 2). The single-family home and plex segments favoured sellers⁴. The conditions in these two segments were therefore somewhat tighter than

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.

in the condominium market, which remained favourable to buyers⁵, but very close to balanced territory. Over the next few quarters, given the expected increase in sales and decrease in supply, market conditions should continue to tighten gradually.

Analysis of the active listings-to-sales ratio of single-family homes by geographic sector also revealed certain differences. On the Island of Montréal and the South Shore, the single-family home segment favoured sellers even more⁶. Market conditions were tightest on Île-des-Sœurs, in the southern portion of the west part of the Island of Montréal, as well as on the South Shore, in Saint-Hubert, with a ratio of 4 to 5 sellers for every buyer⁷.

The single-family home market conditions also tightened, becoming slightly more favourable to sellers in Laval and balanced on the North Shore. Conditions also tightened in Vaudreuil-Soulanges and moved into balanced territory.

In the condominium segment, while market conditions tightened in most of the CMA's large sectors (except Vaudreuil-Soulanges), the market remained favourable to buyers. Some sectors stood out, such as Le Sud-Ouest (Island of Montréal) and Boucherville–Saint-Bruno (South Shore) with a ratio of close to 8 sellers for 1 buyer, at the limit of a market favourable to sellers. While market conditions tightened, Laval and the North Shore still posted the

softest market conditions (15.5 sellers for 1 buyer). As mentioned in the previous quarter's HMA, the supply of condominiums on the North Shore is of some concern. Supply on both the existing and new home markets remains high, putting little pressure on prices⁸.

Weak evidence of price growth acceleration

Evidence of price acceleration remained weak in the first quarter of 2017. That said, the tightening market conditions observed over the last few quarters have supported the growth rate in the average price of existing homes. In the first quarter of 2017, the average Centris® price⁹ (adjusted for inflation and for seasonal variations) rose by 0.7% relative to the fourth quarter of 2016, the same pace as in the previous quarter. This growth was still below the problematic threshold, but moving closer to it. However, it did not reach the levels recorded in 2010¹⁰.

In both the single-family housing and condominium segments, price growth accelerated in the first quarter of 2017, compared to the previous quarter¹¹. This situation applied to the CMA as a whole, except in Vaudreuil-Soulanges.

In the single-family home segment, price growth accelerated the most on the Island of Montréal, climbing from 1% (in annual variation) in the first quarter of 2016 to 8.2% in the

first quarter of 2017. Several sectors, including Saint-Laurent, Côte-des-Neiges–Notre-Dame-de-Grâce–Côte-Saint-Luc and the Centre (including Westmount), saw home prices climb at a faster pace. The South Shore also stood out with a price growth of over 4% in the first quarter, up from 1.3% in the first quarter of 2016. Most of the sectors on the South Shore recorded an increase in single-family home price growth (except Sainte-Julie–Varembes and Le Sud-Ouest).

In the condominium segment, price growth also accelerated the most on the Island of Montréal in the past few quarters, climbing to 4.8% in the first quarter of 2017 from 1.6% in the first quarter of 2016. In particular, the sectors of Côte-des-Neiges–Notre-Dame-de-Grâce–Côte-Saint-Luc, Île-des-Sœurs, Ville-Marie and Rosemont saw condominium prices climb at a faster pace. It should also be mentioned that on the North Shore, growth was slightly positive following four quarters of decrease.

Finally, while evidence of price growth acceleration on the Montréal existing home market remained weak in the first quarter, this indicator will have to be closely monitored over the upcoming quarters. With the economic outlook remaining favourable to housing demand, it would not be surprising for market conditions to tighten gradually and cause, in turn, a faster increase in 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.

⁷ In a sellers' market, the ratio is below 8 sellers (active listings) to 1 buyer (Centris® sales), in a balanced market, the ratio is between 8 to 1 and 10 to 1 and in a buyers' market the ratio is greater than 10 to 1.

⁸ It should be specified that these more detailed information by geographical sector and housing type are provided to support the aggregate results of the HMA for the CMA. The HMA analytical framework cannot make such a precise diagnostic for the sectors of the CMA or the various housing types.

⁹ Weighted average price for the last 12 months.

¹⁰ Even with greater price growth in 2010, evidence of price growth acceleration remained weak, under the problematic threshold.

¹¹ In the first quarter of 2017, the annual growth in the average weighted Centris® price (not seasonally adjusted) of single-family homes and condominiums was 4.9% and 4.4%, respectively.

Weak evidence of overvaluation

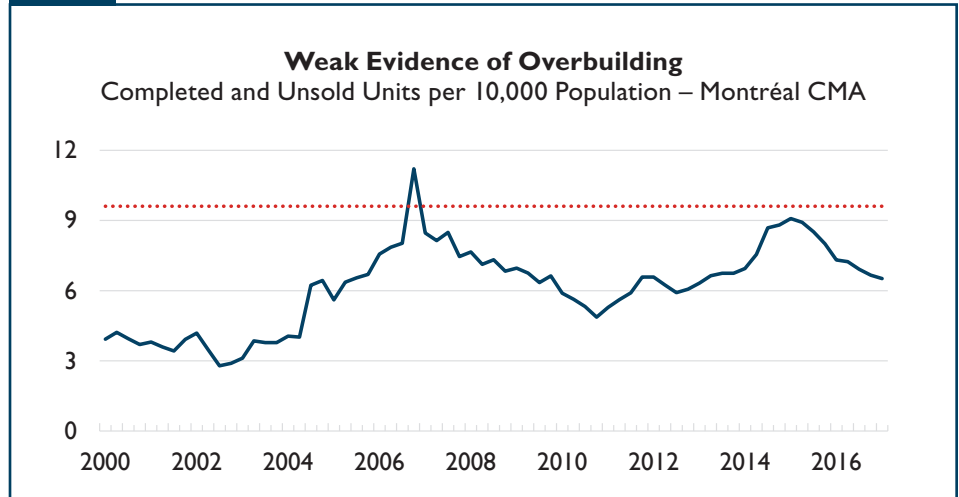
In the first quarter of 2017, the growth in economic and demographic fundamentals justified the price levels observed on the housing market. The HMA continued to detect weak evidence of overvaluation, which means that the gap between real house prices and a price level that would have been dictated by housing market fundamentals, such as personal disposable income and the population, remained below the problematic threshold.

In more details, most of the fundamentals were stronger in the first quarter of 2017 versus the fourth quarter of 2016. Population grew by 0.2%, the five-year fixed rate¹² decreased from 3.2% to 2.6% and real personal disposable income per capita rose by 0.5%.

Real house prices (adjusted for inflation and seasonal variations) evolved in different directions. On the one hand, the average Centris® price (+0.7%) and the Teranet–National Bank House Price Index (+1.3%) rose compared to the previous quarter. On the other hand, Statistics Canada's New Housing Price Index (NHPI) (-0.3%) and the MLS® Home Price Index (-0.3%) decreased.

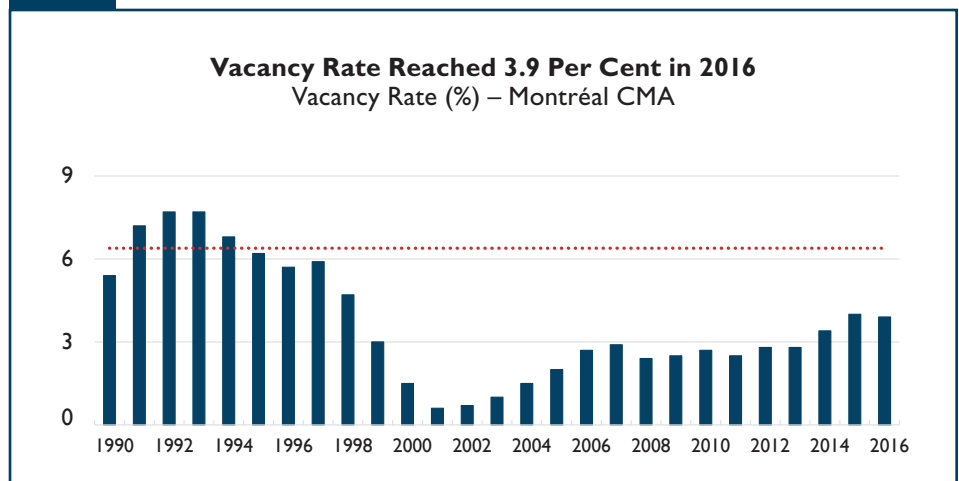
Since 2016, economic conditions in the Montréal area have remained favourable to housing demand. In that sense, even if prices have increased, it was in a context of improving fundamentals. In the last quarter of 2016 and in the first quarter of 2017, the overvaluation exercise showed that there was little difference between real house prices and the prices dictated by fundamentals. Therefore, evidence of overvaluation was weak or even non-existent.

Figure 3



Sources: Statistics Canada and CMHC.
Last data point: 2017 Q1.

Figure 4



Source: CMHC.
Last data point: October 2016.

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 first quarter of 2017, 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 in the first quarter of 2017 reached 6.5, well below the threshold of 9.6 that corresponds to evidence of overbuilding in the Montréal CMA. The decrease of this overbuilding index, observed since the last high at the beginning of 2015 (see figure 3),

¹² Adjusted for the inflation observed in the Montréal CMA in the first quarter.

resulted from the combination of a decrease in inventory and an increase in population. The decrease in inventory was more due to the marked slowdown in condominium starts¹³ and, therefore, in completions, than to a greater absorption rate.

Builders therefore appear to have been selling off unsold new condominiums, instead of starting new projects or new phases, which maintained the number of completions at lower levels in 2015 and 2016

As we mentioned in a previous issue of the HMA for the Montréal CMA¹⁴, 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 up the number of units under construction. This could lead to a slight increase in the inventory of completed and unsold condominiums over the next few quarters. However, most of these units have been presold.

As for the vacancy rate, it remained stable, at 3.9%, 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.

¹³ Condominium starts decreased by 25% in 2015 and by 14% in 2016.

¹⁴ 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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